COMPARATIVE DESCRIPTION OF PROPOSALS RELATING TO PENSION ACCESS AND SIMPLIFICATION (H.R. 2730, H.R. 2641, H.R. 2742, and Other Proposals)

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SUBCOMMITTEE ON SELECT REVENUE MEASURES

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CONTENTS

		Page
INTRODUCTION		1
I.	GENERAL SIMPLIFICATION ISSUES	2
II.	COMPARATIVE DESCRIPTION AND ANALYSIS OF VARIOUS PROPOSALS	8
A.	Distribution Rules	8
1.	Rollovers of qualified plan distributions	8
a.	In general	8
b.	Governmental plans	9
2.	Rules relating to lump-sum distributions	11
a.	Income averaging	11
b.	Net unrealized appreciation of employer securities	11
c.	$5,000 death benefit exclusion	12
d.	Excise tax on excess distributions	12
3.	Recovery of basis under a qualified plan	16
4.	Trustee-to-trustee transfers	18
5.	Minimum required distributions	20
B.	Increased Access to Pension Plans	22
1.	Simplified employee pensions	22
a.	Salary reduction simplified employee pensions	22
b.	Eligibility requirements	23
2.	Repeal of limitation on ability of State and local governments and tax-exempt employers to maintain cash or deferred arrangements	25
3.	Duties of master and prototype plan sponsors	26
C.	Nondiscrimination Provisions	27
1.	Nondiscrimination rules relating to qualified cash or deferred arrangements, matching contributions, and after-tax employee contributions	27
a.	Qualified cash or deferred arrangements	27
b.	Employer matching contributions and after-tax employee contributions	28
2.	Modification to definition of leased employee	32
3.	Definition of highly compensated employee	34

4. Nondiscrimination, coverage, and participation 37

a. Nondiscrimination testing based on average rate of accruals 37
b. Social security supplements 37
c. Transfer of employees 37
d. Special grandfather rule for integrated plans 38
e. Definition of compensation 38
f. Separate line of business rules 39
g. Inclusion of union employees for coverage testing 39
h. Special coverage rule for airline pilots 40
i. Minimum participation rule 40
j. Effective dates for miscellaneous provisions 41

D. Miscellaneous Pension Simplification 44

1. Other core qualification requirements 44

a. Definition of retirement age 44
b. Modifications to full funding limitation 44
c. Vesting in multiemployer plans 45
d. Date for adoption of plan amendments 45

2. Other miscellaneous changes 48

a. Cost-of-living adjustments 48
b. Half-year requirements 48
c. Plans for self-employed individuals 48
d. Penalties for failure to file reports of pension and annuity payments 49
e. Contributions for disabled employees 49
f. Determination of employee contributions under defined benefit plans 49
g. VEBA affiliation requirements 50
h. In-service distributions from rural cooperative plans 50
i. Effective date for miscellaneous changes 51

E. Plans of State and Local Governments and Tax-Exempt Organizations 53

1. Modifications to limits on contributions and benefits 53
2. Section 457 not applicable to nonelective deferred compensation 54

III. OTHER PROPOSAL: H.R. 2390 56

INTRODUCTION

This document,[1] prepared by the Staff of the Joint Committee on Taxation, provides a comparison of various proposals relating to pension access and simplification scheduled for a hearing on July 25, 1991, before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means.

Part I of the document is a discussion of general pension access and simplification issues. Part II is a comparative description and discussion of the provisions of H.R. 2730 (Pension Access and Simplification Act of 1991, introduced by Mr. Rostenkowski), the Administration's POWER proposal, H.R. 2641 (Employee Benefits Simplification Act of 1991, introduced by Mr. Chandler), and H.R. 2742[2] (Employee Benefits Simplification Act, introduced by Mr. Cardin). Part III is a description of another related proposal, H.R. 2390 (Pension Coverage and Portability Improvement Act of 1991, introduced by Mr. Gibbons).

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[1] This document may be cited as follows: Joint Committee on Taxation, Comparative Description of Proposals Relating to Pension Access and Simplification (H.R. 2730, H.R. 2641, H.R. 2742, and Other Proposals (JCX-13-91), July 24, 1991.

[2] H.R. 2742 is identical to S. 1394 (introduced by Senators Bentsen and Pryor).

I. GENERAL SIMPLIFICATION ISSUES

Overview of qualified plans[3]

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan) is accorded special tax treatment under present law. The employer maintaining the plan is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee is not required to include qualified plan benefits in income until the benefits are distributed from the plan. Contributions to a qualified plan are held in a tax-exempt trust.

The special tax benefits for qualified plans represent a significant tax expenditure. For fiscal year 1992, the tax expenditure for the net exclusion for pension contributions and earnings is estimated to be $54 billion.[4] The purpose of the tax benefits provided with respect to qualified plans is to encourage employers to establish broad-based retirement plans for their employees. Employer-provided pension plans reduce the need for public assistance and reduce pressure on the social security system.

Qualified plans are broadly classified into two categories: defined contribution plans and defined benefit pension plans. There are several different types of defined contribution plans, including money purchase pension plans, profit-sharing plans, stock bonus plans, and employee stock ownership plans (ESOPs).

The qualification standards and related rules governing qualified plans are generally designed to ensure that qualified plans benefit an employer's rank-and-file employees as well as the employer's highly compensated employees. They also define the rights of plan participants and beneficiaries and provide limits on the tax deferral possible under qualified plans.

The qualification rules include minimum participation rules that limit the age and service requirements an employer can impose as a requirement of participation in a plan; coverage and nondiscrimination rules designed to prevent qualified plans from discriminating in favor of highly compensated employees; vesting and accrual rules which limit the period of service an employer can require before an employee earns or becomes entitled to a benefit under a plan; limitations on the contributions made on behalf of and benefits of a plan participant; and minimum funding rules designed to ensure the solvency of defined benefit pension plans. The Internal Revenue Code (the Code) also contains rules regarding the taxation of qualified plan benefits; terminations of qualified plans; and rules designed to prevent plan fiduciaries and others closely associated with a plan from misusing plan assets.

The present-law rules governing qualified plans originated in the Employee Retirement Income Security Act of 1974 (ERISA). ERISA forms the basis for the current private pension system. The rules enacted in ERISA have been revised several times. The most comprehensive revision of the qualification rules since the enactment of ERISA was made by the Tax Reform Act of 1986.

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[3] For a detailed discussion of the rules governing tax-qualified plans, see Joint Committee on Taxation, Present-Law Tax Rules Relating to Qualified Pension Plans (JCS-9-90), March 22, 1990.

[4] See Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 1992-1996 (JCS-4-91), March 11, 1991.

In addition to the qualification rules under the Code, pension plans are also subject to regulation under the labor law provisions of ERISA.

Sources of retirement income

There are three potential sources of income for an individual after retirement--social security benefits, employer-provided pension plan benefits, and personal savings. These three sources of retirement income have traditionally been referred to as the "three-legged stool" providing retirement income security. Taken together, these three sources of income ideally should provide an adequate replacement for preretirement income.

An employer's decision to establish or continue a pension plan for employees is voluntary. The Federal tax laws provide favorable tax treatment for amounts contributed to an employer-provided pension plan to encourage the establishment and continuance of such plans.

The Federal laws and regulations governing employer-provided retirement benefits are recognized as among the most complex set of rules applicable to any area of the tax law. Some have argued that this complexity has made it difficult, if not impossible, for employers, particularly small employers, to comply with the law. In addition, it is asserted that this complexity deters employers from establishing pension plans or forces the termination of such plans. If this assertion is accurate, then the complexity of the employee benefits laws is reducing the number of employees covered under employer-provided plans. Such a result then forces social security and personal savings to assume more of the burden of replacing preretirement income.

Others assert that the complexity of employee benefits laws and regulations is a necessary byproduct of attempts (1) to ensure that retirement benefits are delivered to more than just the most highly compensated employees of an employer, (2) to provide employers, particularly large employers, with the flexibility needed to recognize the differences in the way that employers do business, and (3) to ensure that retirement benefits generally are used for retirement purposes.

A brief discussion follows of the underlying reasons for complexity in the pension area.

Reasons for complexity in employee pension benefits laws

Volume and frequency of employee benefits legislation

Many employers and practitioners in the pension area have argued that the volume of legislation affecting pension plans enacted since 1974 has contributed to complexity. In many cases, a particular substantive area of pension law may be dealt with legislatively every year. For example, the rules relating to the form and taxation of distributions from qualified pension plans were significantly changed by the Tax Equity and Fiscal Responsibility Act of 1982, the Deficit Reduction Act of 1984, the Retirement Equity Act of 1984, and the Tax Reform Act of 1986. In many cases, changes in the Federal laws relating to pension plans are requested by employers and practitioners.

Constant change of the laws governing pension plans has not only contributed to complexity for the employer, plan administrator, or practitioner who must understand the rules, but has also created problems for the Internal Revenue Service (IRS) and Department of Labor. Regulations projects are so backlogged at the IRS that employers may not know what they must do to bring their pension plans into compliance with enacted legislative changes because the IRS has been unable to publish adequate guidance.

The amount of legislation in the pension area in recent years hinders the ability of the IRS and the Department of Labor to monitor compliance with the law. Significant amounts of resources are required to be expended to educate government employees with respect to changes in the law. Time that is spent reviewing pension plan documents to determine whether they qualify under the tax laws in form takes time away from the auditing of plans to ensure that they qualify in operation.

The level of legislative and regulatory activity in the pension area has also created problems because inadequate time is available to consider the possible interaction of various provisions. The IRS may issue regulations that are immediately superseded by legislation. Legislation is enacted that does not consider the potential interaction problems created with other areas of employee benefits law.

Some people argue that the rules relating to employer-provided pension plans should not be significantly altered in the context of an effort to simplify the rules. This argument assumes that additional changes in the employee benefits area will only contribute to complexity by legislating again in an area that some say has been overlegislated in the last 10 years.

On the other hand, legislative initiatives that merely repeal existing rules may not contribute to additional complexity of the rules unless the repeal of such rules leaves uncertainty as to the rule that applies in place of the repealed rule.

The structure of the workplace

Some argue that the complexity of the rules relating to pensions stems from a problem that is not unique to the employee benefits area--that is, the way in which the workplace has developed has created inherent complexities in the way that legislation is enacted. The way in which employers do business affects the complexity of pension legislation.

Large employers tend to have complex structures. These complex structures may include the division of employees among various subsidiaries that are engaged in different types of businesses. Rules are required to deal with the issues that arise because a business is operated in many tiers. For example, questions arise as to which employees are required to be taken into account in determining whether an employer is providing pension benefits on a nondiscriminatory basis. To what extent are employees of various subsidiaries that are engaged in completely different activities required to be aggregated? If these employees must be aggregated for testing purposes, what kind of recordkeeping burdens are imposed on the employer? How are headquarters employees treated and how does the treatment of such employees differ from the treatment of subsidiary employees? If an employer retains temporary workers, to what extent are such workers required to be taken into account? Should employees covered by collective bargaining agreements be treated differently than other employees? Employers face these issues every day because of the way in which their businesses are operated, rather than simply because the laws governing pension benefits are complex.

Flexibility and complexity

Employers and employees generally want to be able to tailor their compensation arrangements, including pension benefits, to fit their particular goals and circumstances. Present law accommodates these desires by providing for various tax-favored retirement savings vehicles, including qualified plans, individual retirement arrangements (IRAs), simplified employee pensions (SEPs), and tax-sheltered annuities. There are many different types of qualified plans, different ways of funding such plans, and different ways of providing benefits under such plans.

The number of different tax-favored retirement arrangements increases complexity in the pension rules because different rules are needed for each type of arrangement. A great deal of simplicity could be achieved, for example, if employers were permitted to choose from only one or two model pension plans. However, this would also greatly reduce the flexibility provided employers and employees under present law.

To some extent, the complexity of present law is elective. For example, employers who wish to reduce complexity can adopt a master or prototype plan. Similarly, an employer may adopt a simple profit-sharing plan for all the employer's employees that involves a minimum of administrative work. However, many employers choose more complicated compensation arrangements.

Complexity and certainty

Although employers and practitioners often complain about the complexity of the rules relating to employer-provided pension plans, some of that complexity is, in fact, attributable to the desire of employers or the Congress to have certainty in the rules. For example, the general nondiscrimination rule relating to qualified pension plans merely requires that a plan not discriminate in either contributions or benefits in favor of highly compensated employees. This rule is easy to articulate; however, determining whether or not the rule is satisfied is not a simple task. The most obvious problem is determining what the word "discriminate" means. If it means that there can be no difference in contributions or benefits between those provided to highly compensated employees and those provided to rank-and-file employees, then the rule may be fairly straightforward. However, because the rules permit employers some flexibility to provide more contributions or benefits for highly compensated employees, then it is necessary to determine how much of a difference in the contributions or benefits is permitted.

On the other hand, rules that provide greater certainty for employers tend, on their face, to appear to be more complex. A case in point are the nondiscrimination rules for employee benefits added in the Tax Reform Act of 1986 (Code sec. 89).[5] Employers complained vigorously about the calculations and recordkeeping requirements imposed by section 89. However, these rules were developed during the legislative consideration of the 1986 Act in large measure in response to employer's complaints about the uncertainty of a general rule prohibiting nondiscrimination in favor of highly compensated employees.

A more mechanical rule will often appear to be more complex, but will also provide more certainty to the employers, plan administrators, and practitioners who are required to comply with the rule. Thus, any attempts to reduce complexity of the employee benefits laws must balance the desire for simplicity against the perceived need for certainty. In addition, it should be recognized that simplicity in legislation does not preclude complexity in regulation.

Retirement policy vs. tax policy

A source of complexity in the development of pension laws and regulations occurs because the Federal Government has chosen to encourage the delivery of retirement benefits by employers through the Federal income tax system. This decision tends to create conflicts between retirement income policy and tax policy.

Retirement income policy has as its goal the delivery of adequate retirement benefits to the broadest possible class of workers. Because the decision to maintain a retirement plan for employees is voluntary,

[5] The rules of section 89 were repealed in 1989. (P.L. 101-140).

retirement income policy would argue for laws and regulations that do not unduly hinder the ability or the willingness of an employer to establish a retirement plan. Such a policy might also encourage the delivery of more retirement benefits to rank-and-file employees by adopting a rule that prohibits discrimination in favor of highly compensated employees, but does not otherwise limit the amount of benefits that can be provided to such employees. Thus, an employer whose principal objective was to provide large retirement benefits to highly compensated employees (e.g., management) could do so as long as the employer also provided benefits to rank-and-file employees.

On the other hand, tax policy will be concerned not only with the amount of retirement benefits being delivered to rank-and-file employees, but also with the extent to which the Federal Government is subsidizing the delivery of such benefits. Thus, Federal tax policy requires a balancing of the tax benefits provided to an employer who maintains a qualified plan in relation to all other tax subsidies provided by the Federal tax laws. This balancing has led the Congress (1) to limit the total amount of benefits that may be provided to any one employee by a qualified plan and (2) to adopt strict nondiscrimination rules to prevent highly compensated employees from receiving a disproportionate amount of the tax subsidy provided with respect to qualified pension plans.

Jurisdiction of pension legislation

When ERISA was enacted in 1974, the Congress concluded that Federal pension legislation should be developed in a manner that limited the Federal tax subsidy of employer-provided retirement benefits and that provided adequate safeguards for the rights of employees whose employers maintained pension plans. Accordingly, the rules adopted in ERISA included changes in the tax laws governing qualified plans (Title II of ERISA) and also included labor law requirements applicable to employer-provided plans (Title I of ERISA). In many cases, these labor law requirements mirrored the requirements of the tax laws and created a civil right of action for employees. Thus, ERISA ensured that compliance with the Federal employee benefits laws could be monitored by the Federal Government (through the IRS and the Department of Labor) and by employees (through their civil right of action under the labor laws).

Although many of the pension laws enacted in ERISA had mirror provisions in the labor laws and in the Internal Revenue Code, subsequent legislation has not always followed the same form. For example, the top-heavy rules that were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 were only included in the Internal Revenue Code and did not contain a corresponding provision in Title I of ERISA. Some have argued that such a piecemeal approach to employee benefits legislation can lead to inconsistencies between the Federal tax law and Federal labor law and can contribute to the overall complexity of the rules governing pension plans.

In addition, the enforcement of rules relating to employer-provided pension plans is shared by the IRS and the Department of Labor. Thus, there is no single agency of the Federal Government that is charged with the development and implementation of regulations and with the operational enforcement of the rules relating to pension plans.

Although the authority of each applicable agency has been clarified, complexity can occur because of the manner in which the agencies interact. An employer must determine the agency with which it must consult on an issue and may find that the goals of each agency are different. For example, the Pension Benefit Guaranty Corporation (PBGC) views the funding of a defined benefit pension plan from its goal of assuring solvency of the plan when benefit payments are due. On the other hand, the IRS is concerned that employers should not be permitted to overfund defined benefit pension plans as a mechanism by which the employer can shelter income from taxation. Without careful coordination of the goals of these two Federal

agencies, employers may receive inconsistent directives.

Transition rules

When the Congress enacts tax legislation altering the tax treatment of qualified pension plans or distributions from such plans, transition relief is often provided to specific employers or individual taxpayers or to a class of employers or taxpayers. Transition relief generally delays temporarily or permanently the application of the enacted rule to the applicable taxpayer. Sometimes, transition relief will apply a modified rule that is a compromise between present law and the enacted rule.

The adoption of transition rules for a taxpayer or a class of taxpayers contributes to the actual and perceived complexity of employee benefits laws.

II. COMPARATIVE DESCRIPTION AND ANALYSIS OF VARIOUS PROPOSALS

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
A. Distribution Rules					
1. Rollovers of qualified plan distributions					
a. In general	A distribution from a qualified plan may be rolled over, tax free, to an IRA or to another qualified plan if (1) the distribution is a qualified lump-sum distribution, or (2) the distribution is a qualifying partial distribution. A qualifying partial distribution is a distribution that (1) is at least 50 percent of the balance to the credit of the employee, (2) is not one of a series of periodic payments, and (3) is made on account of the employee's death, disability, or separation from service with the employer. A lump-sum distribution is a distribution within one taxable year of the balance to the credit of an employee that becomes payable to the recipient (1) on account of the death of the employee, (2) after the employee attains 59-1/2, (3) on account of the employee's separation from service, or (4) in the case of self-employed individuals, on account of disability. A distribution is not treated as a lump-sum distribution unless the employee has been a participant in the plan for at least 5 years	The bill allows an employee or surviving spouse to roll over any portion of a qualified plan distribution received, unless the distribution is (1) a minimum required distribution (sec. 401(a)(9)), (2) attributable to after-tax employee contributions, or (3) part of a stream of periodic payments payable over a period of 5 years or more, or over the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and his or her beneficiary.	The proposal allows an employee or surviving spouse to roll over any portion of a qualified plan distribution received, unless the distribution is (1) a minimum required distribution, (2) attributable to after-tax employee contributions, or (3) part of a stream of periodic payments payable over a period of 10 years or more, or over the life (or life expectancy) of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary.	The bill allows an employee or surviving spouse to roll over any portion of a qualified plan distribution, other than a minimum required distribution. If any portion of a lump-sum distribution is rolled over, 5-year forward averaging is not available with respect to the rest of the distribution.	Same as H.R. 2641, except that distributions attributable to after-tax employee contributions may not be rolled over.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	before the date of distribution. Amounts attributable to (1) after-tax employee contributions or (2) minimum required distributions (sec. 401(a)(9)) may not be rolled over.				
b. Governmental plans	No special rules apply with respect to the eligibility of participants in government pension plans to roll over plan distributions.	No provision.	No provision.	No provision.	The bill provides relief to employees who received distributions from a governmental plan in connection with the transition to a new retirement system and who erroneously treated the distributions as eligible for rollover treatment. Extends relief provided by the IRS for calendar years 1987, 1988, and 1989 to 1990.
		Effective date.--Taxable years beginning after December 31, 1991.	Effective date.--None specified.	Effective date.--Distributions after December 31, 1991.	Effective date.--General rule is effective for distributions after December 31, 1991. Special rule for governmental plans is effective on date of enactment.

DISCUSSION

The present-law rules relating to rollovers of distributions from a qualified plan to an IRA or to another qualified plan represent an exception to the fundamental tax law principle that income should be taxed when it is actually or constructively received. The rollover rules are intended to facilitate the retention of retirement savings for retirement purposes when an individual either (1) separates from service prior to retirement age or (2) receives a lump-sum distribution from a qualified plan.

The rollover rules originally were available only in the case of certain lump-sum distributions. Because the original rollover provisions created harsh results in the case of inadvertent failures to receive a lump-sum distribution, the Congress has liberalized the rollover rules. However, the liberalizations, while eliminating many of these harsh results, have complicated the rollover rules to the point that the average plan participant will be unable to determine in many cases whether a distribution can be rolled over. The restrictions on rollovers under present law lead to numerous inadvertent failures to satisfy the rollover requirements and contribute significantly to the complexity of the rules relating to the taxation of pension distributions. The proposals significantly liberalize the circumstances under which a distribution from a qualified plan may be rolled over, tax free, to an IRA or to another qualified plan. This liberalization and the resulting simplification that it achieves must be balanced against the fundamental principle that income

should be taxed when it is actually or constructively received by a taxpayer.

Because H.R. 2730 and the Administration proposal prohibit the rollover of certain periodic payments, a factual determination may be required to determine whether any particular payment is part of a stream of periodic payments. It is likely that such factual determinations may continue some of the complexity attributable to the rollover provisions. Thus, some argue from a simplification perspective that the ability to roll over a qualified plan distribution should not be restricted in the case of payments that are part of a stream of annuity payments. However, if the annuity restriction were eliminated, the rollover rules would permit taxpayers to roll over all or part of each retirement annuity payment and could result in a significant revenue loss to the Federal government because liberal rollover rules allow an individual to decide when and how a retirement benefit will be taxed. On the other hand, persons who are able to obtain a lump-sum distribution from a qualified plan will have such ability simply by rolling over the distribution to an IRA and making withdrawals from the IRA at will.

H.R. 2730, the Administration proposal, and H.R. 2742 do not permit the rollover of after-tax employee contribution. The concern with permitting rollovers of employee contributions is primarily administrative rather than a policy concern. Permitting the rollover of employee contributions is consistent with retirement policy; individuals should be permitted to keep all their retirement savings in a tax-favored arrangement until retirement. However, the administrative problems of keeping track of basis in an IRA may be difficult. Employers maintaining qualified plans to which after-tax employee contributions have been made often comment that they would like to eliminate recordkeeping burdens by cashing out employee contributions. Permitting such contributions to be rolled over to an IRA would merely shift, rather than solve, the recordkeeping problems.

Those who favor expansion of the tax-free rollover rules argue that further liberalization of the rules would (1) benefit individuals whose employer forces a distribution of pension benefits at a time when an individual does not want to consume it, and (2) allow individuals to change investment media in response to changed investment opportunities.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
Rules relating to lump-sum distributions					
a. Income averaging	5-year averaging.--Under present law, lump-sum distributions from qualified plans and annuities are eligible for special 5-year forward income averaging.	5-year averaging.--The bill repeals 5-year forward income averaging for lump-sum distributions.	5-year averaging.--Same as H.R. 2730.	5-year averaging.--Same as H.R. 2730, but with a delayed effective date.	5-year averaging.--Same as H.R. 2730.
	Transition rules.--Special transition rules adopted in the Tax Reform Act of 1986 are available with respect to an employee who attained age 50 before January 1, 1986. Under these rules, an individual, trust, or estate may elect (1) 5-year forward averaging (using present-law tax rates), (2) 10-year forward averaging (using the tax rates in effect before the Tax Reform Act of 1986), or (3) long-term capital gains treatment for the pre-1974 portion of a lump-sum distribution.	Transition rules.--The bill repeals the special transition rules under the Tax Reform Act of 1986.	Transition rules.--Same as H.R. 2730.	Transition rules.--The bill retains the special transition rules.	Transition rules.--The bill retains the special transition rules.
b. Net unrealized appreciation of employer securities	Under present law, a taxpayer is not required to include in gross income amounts received in the form of a lump-sum distribution to the extent that the amounts are attributable to net unrealized appreciation in employer securities. Such unrealized appreciation is includible in gross income when the securities are sold or exchanged. In addition, gross income does not include net unrealized appreciation on employer	The bill repeals the special treatment of net unrealized appreciation in employer securities.	Same as H.R. 2730.	No provision.	No provision.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	securities attributable to employee contributions.				
c. $5,000 death benefit exclusion	Under present law, the beneficiary or estate of a deceased employee generally may exclude from gross income up to $5,000 in benefits paid by or on behalf of an employer by reason of the employee's death.	The bill repeals the exclusion from gross income of up to $5,000 of employer-provided death benefits.	No provision.	No provision.	No provision.
d. Excise tax on excess distributions	A 15 percent excise tax is imposed on excess distributions from qualified plans. Excess distributions are aggregate distributions from qualified retirement plans made with respect to an individual during any calendar year to the extent the distributions exceed the greater of (1) $150,000, or (2) $112,500 (indexed). A special higher ceiling applies for purposes of determining excess distribution for any calendar year in which an individual receives a lump-sum distribution. The higher ceiling is 5 times the otherwise applicable ceiling for the calendar year (generally, $750,000).	The bill repeals the special higher ceiling applicable to lump-sum distributions for purposes of determining whether an individual receives excess distributions during any calendar year.	No provision.	No provision.	Same as H.R. 2730.
		Effective date.--Taxable years beginning after December 31, 1991. However, 5-year averaging and the 1986 Act transition rules apply to 50 percent of any lump-sum distribution received in years beginning in 1992.	Effective date.--None specified.	Effective date.--5-year averaging is repealed for distributions received in taxable years after December 31, 1996.	Effective date.--Distributions after December 31, 1991.

DISCUSSION

In general

In almost all cases, the burden of determining the extent to which and how a distribution from a qualified plan, tax-sheltered annuity, or IRA is taxed rests with the individual receiving the distribution. Under present law, this task can be burdensome. Among other things, the taxpayer must consider (1) whether special tax rules (e.g., 5- or 10-year income averaging or the special treatment of net unrealized appreciation) apply that reduce the tax that otherwise would be paid, (2) whether the distribution is eligible to be rolled over to another qualified plan or an IRA, (3) the amount of the taxpayer's basis in the plan and the rate at which such basis is to be recovered, and (4) whether or not a portion of the distribution is excludable from income as a death benefit. Simplifying these rules could benefit as many as 16 million individual taxpayers.

The special rules applicable to lump-sum distributions (i.e., income averaging and net unrealized appreciation) encourage individuals to withdraw funds from tax-favored retirement arrangements in a manner that is inconsistent with the policy of providing individuals with income at retirement. Further, spouses may receive greater survivor benefits under a profit-sharing or stock bonus plan if the special treatment of lump-sum distributions is repealed because employees are less likely to withdraw and spend a lump-sum distribution from a profit-sharing or stock bonus plan if they are not eligible for special tax treatment with respect to the distribution.

The special tax treatment accorded to lump-sum distributions under present law creates undue complication of the rules relating to the taxation of pension distributions. In part, these rules are designed to prevent abuses. For example, the rules relating to tax-free rollovers could be substantially simplified it if were not necessary to prevent inappropriate eligibility for income averaging.

Results similar to those under present law can be obtained without the complexity added by the special tax rules of present law. Liberalization of the rollover rules will increase the flexibility of taxpayers in determining the timing of the income inclusion of pension distributions and eliminate the need for special rules such as income averaging and the special rules for unrealized appreciation on employer securities.

Income averaging

The original purpose of the income averaging provisions was to mitigate the effect of the graduated tax rate structure on individuals receiving all of their benefits in a single year. The same purpose can be served, however, by permitting individuals more flexibility in the ability to roll over qualified plan distributions to IRAs or to other qualified plans. This results in the individual being taxed only as amounts are subsequently withdrawn from the IRA or other plan. If more liberal rollovers are permitted, income averaging provides an inappropriate incentive to individuals to consume retirement savings.

On the other hand, elimination of the income averaging rules may result in hardships to certain taxpayers. An individual's retirement income needs may be greater at the time of retirement than in later years. For example, some people may need a large amount of cash in the year of retirement to purchase a home suitable for retirement. Under present law, the home may be purchased without incurring any substantial debt. If the income averaging rules are repealed, then the individual may find it necessary to purchase the home subject to a mortgage and to make the mortgage payments from funds held in a

tax-favored retirement arrangement. Thus, the repeal of averaging could interfere with the objectives of retirees who do not want to be burdened with debt. In addition, some would argue that a retiree who uses a lump-sum distribution to acquire a home for retirement free of debt has used the lump-sum distribution for retirement purposes.

For some individuals, the decision to withdraw and consume a lump-sum distribution is not discretionary because of their income needs. These individuals will not be able to utilize the tax-free rollover provisions to mitigate the effect of repeal of the income averaging rules for lump-sum distributions. The people for whom lump-sum distributions are not discretionary are more likely to be low-income taxpayers than those for whom lump-sum distributions are discretionary.

The repeal of the special transition rules for 10-year averaging and capital gains treatment retained in the Tax Reform Act of 1986 may cause problems for some taxpayers who relied on the availability of the averaging rules to delay lump-sum distributions. This problem may be mitigated to some extent by a rule that allows taxpayers a period of time during which to take their lump-sum distributions and utilize all or a portion of the tax benefit accorded by the special transition rules. On the other hand, not all taxpayers have sufficient control over their retirement savings to determine the year in which they will receive their lump-sum distributions. Maintaining the special transition rules, however, adds to the complexity of the distribution rules.

Net unrealized appreciation

Some of the arguments for eliminating the special treatment of net unrealized appreciation (NUA) in employer securities generally are similar to the arguments presented for eliminating income averaging for lump-sum distributions. Special NUA treatment may provide a mechanism for using retirement funds as a nonretirement investment. The taxpayers who can best afford to avoid current income tax on pension benefits by holding employer securities may not be the class of taxpayers for whom special tax treatment is justified.

Under present law, an exemption from tax is provided if employer securities have not been sold before the employee's death. The NUA is excluded, not merely deferred, because heirs take the securities with a stepped-up basis. This exclusion is available even though there is no longer any general estate tax exclusion for qualified pension plan benefits. Some have argued that the provision of additional tax benefits for employer securities is inappropriate.

In addition, if employer securities for which NUA treatment has been provided are sold, the gain on such securities is taxed as long-term capital gains, whereas the gain on all other pension benefits, including benefits attributable to other property and securities, is treated as ordinary income. Some have questioned whether this special tax treatment of employer securities is justified, and argue that employer securities should be taxed in the same manner as other distributions.

Some argue that the special tax treatment of NUA may be necessary in the case of individuals whose sole retirement benefits are employer securities. Such an individual may be forced to bear the administrative expense of maintaining an IRA merely to continue the deferral of income tax on the securities. It may be difficult for an individual to find an IRA trustee willing to hold only the employer securities and, thus, the administrative expenses charged to the individual may be significant.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742

$5,000 death benefit exclusion

The exclusion of certain employer-provided death benefits from an employee's income creates a preference for what is, in effect, an alternative form of employee compensation. In the absence of restrictions on the availability of the exclusion (such as conditioning the exclusion on broad-based eligibility of employees for the benefit), death benefits may become more of a vehicle to provide tax-free compensation for highly paid employees, rather than a means to enhance the security of employees' families generally.

The exclusion is so small as to amount generally to no more than a tax-free payment of funeral expenses by an employer. However, the existence of the exclusion is conditioned upon payment of the benefit in a lump sum within the meaning of the rules relating to lump-sum distributions. If the exclusion is retained, then many of the rules defining a lump-sum distribution must be retained. Thus, the retention of such a small exclusion must be balanced against the corresponding complexity that must also be retained.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
3. Recovery of basis under a qualified plan	Under present law, a pro-rata basis recovery rule generally applies to the receipt of benefits from a qualified plan, so that the portion of any annuity payment that represents a nontaxable return of basis is determined by applying an exclusion ration equal to the employee's total investment in the contract divided by the total expected payments over the term of the annuity. Under a simplified alternative method provided by the IRS, the exclusion ratio is determined by dividing the employee's total investment in the contract by the number of anticipated payments listed in a simplified table published by the IRS. The simplified table provides anticipated payments that vary based only on the age of the employee on the annuity starting date.	Under the bill, the portion of an annuity distribution that represents nontaxable return of basis generally is determined under a method similar to the present-law simplified method provided by the IRS. The simplified method does not apply if the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity. Effective date.--Years beginning after December 31, 1991.	No provision.	No provision.	No provision.

DISCUSSION

The rate at which an individual recovers his or her basis (e.g., investment in the contract) under a tax-favored retirement arrangement presents complicated measurement problems in addition to the tax policy issue of when a taxpayer should be taxed on income.

The number of special rules for taxing pension distributions under present law makes it difficult for taxpayers to determine which method is best for them and also increases the likelihood of errors. In addition, the specifics of each of the rules create significant complexity for the individual taxpayers who must determine the correct tax treatment of a pension distribution. For example, the present-law rules for determining the rate at which a participant's basis in a qualified plan is recovered often entail calculations that the average participant has difficulty performing. These rules require a fairly precise estimate of the period over which benefits are expected to be paid. The IRS publication on taxation of pension distributions contains over 60 pages of actuarial tables used to determine total expected payments.

The IRS has provided a simplified method for determining basis recovery under present law.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	However, because the use of this simplified method is elective on the part of the individual taxpayer, taxpayers must determined whether or not it is to their advantage to elect to use the simplified method. Thus, the availability of an elective simplified method does not significantly reduce the administrative burden on taxpayers under present law.				

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
4. Trustee-to-trustee transfers	Under present law, a qualified plan may, but is not required, to permit trustee-to-trustee transfers of plan assets with respect to a plan participant to another qualified plan or to an IRA. Qualified plans are not required to accept trustee-to-trustee transfers.	The bill requires plans to allow participants to elect to have distributions transferred directly to another qualified plan or to an IRA rather than receiving the distribution. As under present law, qualified plans are not required to accept trustee-to-trustee transfers.	Same as H.R. 2730.	No provision.	The bill generally requires the transfer of distributions in excess of $500 directly to an IRA or to a qualified defined contribution plan that provides for the acceptance of the transfer. Annuity distributions, distributions after age 55, distributions on account of the death of the employee (other than distributions to the surviving spouse), and hardship distributions are not subject to the transfer requirement.
		Effective date.--Years beginning after December 31, 1992.	Effective date.--None specified.		Effective date.--Distributions in plan years beginning after December 31, 1992.

DISCUSSION

The provisions permitting or requiring qualified plan distributions to be transferred directly to an IRA or to another qualified plan promote the goal of retirement policy that retirement savings should be retained in tax-qualified arrangements until retirement age. Facilitating the transfer of money to a tax-favored retirement arrangement will reduce the number of inadvertent errors that are made by plan participants in complying with the rollover requirements. Furthermore, by placing additional administrative burdens on plan administrators to make transfers on behalf of plan participants, it is less likely that plan participants will withdraw and consume their retirement savings.

In addition, rules easing the transfer of funds between qualified plans and IRAs or other qualified plans improves the portability of pension benefits. As the U.S. work force becomes more mobile, policies that make it easier for individuals to accumulate sufficient retirement income become more important. Thus, provisions that encourage individuals to retain, rather than consume, retirement savings (e.g., the liberalization of rollover rules) and that reduce the administrative burdens on individuals to keep track of retirement savings in a number of different arrangements are likely to complement the goal of ensuring adequate retirement savings.

The provision in H.R. 2742 requiring, rather than permitting an employee to elect, a trustee-to-trustee transfer to an IRA or a defined contribution plan that accepts such distributions reduces the likelihood that retirement savings will be spent for nonretirement purposes by forcing the employee to take an affirmative action (withdrawal from the transferee plan) in order to have access to the distribution. It can be argued that such a provision may make it more likely that at least a portion of retirement savings will remain in a tax-favored arrangement and that the employee will have adequate sources of retirement income when it is needed.

Plan administrators may argue that the trustee-to-trustee transfer rules, whether mandatory (as in H.R. 2742) or voluntary (as in H.R. 2730 and the Administration proposal), increase the complexity relating to pension plan administration. Plan administrators will be required to communicate extensively with plan participants to get sufficient information to process a trustee-to-trustee transfer. In addition, if such a transfer is mandatory and the plan participant fails to designate an appropriate IRA or qualified plan to which plan assets are to be transferred, then the plan administrator will be required to establish an IRA on behalf of the plan participant. Further, the plan administrator will be required to notify employees of the requirements of the transfer provision of the amount to be transferred. Thus, the provision imposes an additional reporting requirement on employers or plan administrators.

In addition, plan trustees may be concerned about their potential liability to plan participants if a trustee-to-trustee transfer is not properly made (for example, if the plan administrator transfers funds to the wrong account) or if other problems arise with respect to the transfer (for example, if the plan administrator establishes an IRA on behalf of a plan participant and the assets in the IRA are depleted by poor investment performance). Although H.R. 2742 specifically relieves plan trustees of responsibility once a transfer is made, plan administrators may argue that such waiver of responsibility will not be sufficient to prevent plan participants from suing the plan fiduciaries in many cases.

It is unlikely that the provisions in H.R. 2730 or H.R. 2742 will increase the number of direct transfers between qualified plans. Plan administrators are generally unwilling to accept direct transfers because the amount transferred could affect the tax qualification of the plan accepting such transfer. For example, the amount transferred may come from a plan that is subsequently determined not to be a qualified plan and the qualified status of the transferee plan could be threatened by the acceptance of assets from a nonqualified plan.

The benefits of the transfer provision (i.e., promoting additional retirement savings) must be balanced against the administrative burdens on employers.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
5. Minimum required distributions	Under present law, distributions from a qualified plan or IRA are generally required to commence no later than April 1 of the calendar year following the year in which the participant attains age 70-1/2. In the case of a plan maintained by a State or local government or a church plan, distributions are required to commence no later than April 1 of the calendar year following the later of the calendar year in which the participant (1) attains age 70-1/2, or (2) retires.	No provision.	No provision.	The bill applies the present-law rules applicable to State and local government plans and church plans to all individuals except (1) 5-percent owners of an employer, (2) employees whose account balance is at least $750,000 when the employee attains age 70-1/2, and (3) IRA owners. The benefits of participants who continue to work for an employer after attaining age 70-1/2 are required to be actuarially increased to take into account the period after age 70-1/2 during which the employee receives no benefits under the plan. Effective date.--Years beginning after December 31, 1991.	Same as H.R. 2641, except that distributions are required to commence at age 70 only in the case of 5-percent owners of an employer and IRA owners. Effective date.--Years beginning after December 31, 1991.

DISCUSSION

A uniform distribution rule for pension benefits was adopted because it reduces disparities in opportunities for tax deferral among individuals covered by different types of plans and eases administrative burdens. The minimum distribution rules are designed to ensure that plans are used to fulfill the purpose that justifies their tax-favored status -- replacement of a participant's preretirement income at retirement -- rather than for the indefinite deferral of tax on a participant's accumulation under the plan.

Some will argue that the application of the required distribution rules to all employees under present law is unnecessary because the vast majority of employees commence distributions prior to age 70. Only in the case of very highly compensated employees is the potential for deferral of receipt of benefits a problem.

The required distribution rule under present law has the effect of eliminating an incentive that employers use to encourage their employees to retire. Some employers prefer to be able to induce employees to retire, thereby creating jobs for younger, and possibly lower-paid, employees by refusing to commence payment of retirement benefits. Under present law, this option is not available to employers; however, H.R. 2641 and H.R. 2742 will permit employers to utilize this incentive.

On the other hand, H.R. 2641 and H.R. 2742 also require a plan administrator to actuarially adjust the benefits payable to an employee under a defined benefit pension plan to reflect the period during which benefits could have been paid, but were not. This provision can also serve as a disincentive to employees to

retire because they will not lose the actuarial value of the retirement benefits they could have been receiving. This provision is necessary to prevent employees from being disadvantaged because payment of their benefits is delayed; however, it also adds complexity for plan administrators.

The provision in H.R. 2641 and H.R. 2742 permitting deferral of commencement of benefits until retirement is similar to a rule that was repealed by the Tax Reform Act of 1986. The return to the pre-1986 Act rules relating to required distributions reintroduces some of the complexities the 1986 Act sought to eliminate. Thus, for example, employers will have to apply different sets of rules to different groups of employees. It may be difficult to determine when someone has retired. For example, if someone is working for an employer on a part-time basis, questions will arise as to whether the individual has retired for purposes of the application of the required distribution rule.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
B. Increased Access to Pension Plans					
1. Simplified employee pensions					
a. Salary reduction simplified employee pensions	Employers (other than tax-exempt and governmental employers) with 25 or fewer employees may maintain a salary reduction simplified employee pension (SEP) for their employees under which employees may elect to have contributions made to the SEP or to receive the contributions in cash. Amounts contributed to the SEP are not included in income until distributed from the SEP. Elective deferrals under a SEP are generally treated in the same manner as elective deferrals under a qualified cash or deferred arrangement and, thus, are subject to the $8,475 cap on elective deferrals. An employer may maintain a salary reduction SEP only if at least 50 percent of the employer's employees elect to have amounts contributed to the SEP. Elective deferrals to a salary reduction SEP are subject to nondiscrimination standards. The amount deferred as a percentage of each highly compensated employee's compensation cannot exceed 125 percent of the average deferral percentage for nonhighly compensated employees.	The bill repeals the present-law rules applicable to salary reduction SEPs and replaces them with new rules. Employers (including tax-exempt and State and local government employers) who do not maintain a qualified plan and with no more than 100 employees can maintain a qualified salary reduction arrangement as pat of a SEP. A qualified salary reduction arrangement must meet the following requirements: (1) the employer must contribute to each eligible employee's SEP an amount equal to 3 percent of the employe's compensation (not in excess of $100,000), or 5 percent if the employer or a predecessor maintained a qualified plan (other than a SEP) during either of the 2 years preceding the year in which the salary reduction SEP is established; (2) each eligible employee must be permitted to make salary reduction contributions of up to $5,000 (indexed) per year; and (3) the employer may make matching contributions equal to no more than 50 percent of the elective contributions made on behalf of the employee. The employer is also required to notify employees of the provisions of the SEP.	Generally the same as H.R. 2370, except that the only minimum required contribution is 2 percent of compensation, and the maximum permitted elective deferrals is one-half of the dollar limitation applicable to qualified cash or deferred arrangements (i.e., for 1991, 1/2 of $8,475, or $4,238).	The bill provides that employers with 100 or fewer employees may maintain salary reduction SEPs and repeals the 50 percent participation requirement for such SEPs. The bill also provides that the 3 percent nonelective contribution safe harbor applicable to qualified cash or deferred arrangements under the bill applies to salary reduction SEPs (see C.1.a., below).	Same as H.R. 2641, except that all the safe harbors applicable to qualified cash or deferred arrangements under the bill apply if employees are notified of the provisions of the SEP.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
		No nondiscrimination rules apply to a qualified salary reduction arrangement.			
b. Eligibility requirements	Under present law, an employer establishing a SEP must make the SEP available to each employee who has attained age 21, has performed service for the employer during at least 3 of the immediately preceding 5 years, and who received at least $300 (indexed) in compensation for the employer for the year.	No provision.	No provision.	The bill replaces the 3-out-of-5 years service requirement with a requirement that employees who have at least 1 year of service must be eligible to participate.	Same as H.R. 2641.
		Effective date.--The provision is effective with respect to years beginning after December 31, 1991, except that the provision does not apply to a salary reduction SEP in effect on the date of enactment unless the employer elects to have the provisions of the bill apply for any year and for all subsequent years.	Effective date.--No date specified.	Effective date.--Years beginning after December 31, 1991.	Effective date.--Years beginning after December 31, 1991.

DISCUSSION

Salary reduction SEPs

Pension coverage of employees of small employers is significantly lower than that of employees of medium or large employers. A number of factors may contribute to this, including the cost to the employer (both in terms of wage cost and administrative cost of maintaining the plan) as well as the desire of the employees to have pension benefits rather than wages in other forms. The proposals attempt to address one factor that may affect an employer's decision to establish a pension plan--administrative burdens--by enabling an employer to establish a salary reduction SEP without testing to ensure that the plan operates in a manner that does not discriminate in favor of highly compensated employees.

Nondiscrimination rules generally are enacted to ensure that the tax benefits for qualified plans benefit an employer's rank and file employees as well as highly compensated employees and to provide broad-based pension coverage. The issues relating to nondiscrimination rules are discussed more fully below under the provision relating to cash or deferred arrangements. This discussion applies equally to the provisions that permit salary reduction SEPs for small employers without testing for nondiscrimination.

In addition, even if one concludes that nondiscrimination rules are generally desirable from a policy perspective, some argue that in the case of small employers such rules may be an impedient to establishment of any type of retirement program and that relaxation of such rules is appropriate if doing so will encourage small employers to establish retirement plans.

It is unclear, however, whether proposals that eliminate nondiscrimination rules for small employers will actually increase pension coverage of rank and file employees. Such employers may establish SEPs now, and may also establish qualified retirement plans that are relatively easy to administer. Thus, the fact that pension coverage is lower in smaller firms may have little to do with administrative costs associated with nondiscrimination rules. Thus, relaxing those rules may not achieve the desired result.

Some also argue that any increased pension contributions by small employers will be reflected in lower wages (to the extent permitted by minimum wage laws) -- which could adversely affect lower-income workers who may desire to have higher current wages. Some also argue that the provision may make hiring minimum wage workers more expensive, so that fewer of such workers will be hired.

Some also argue that it is not fair to provide special rules to small employers only, and that one set of rules ought to apply to all employers. In addition, as a practical matter, it may be difficult to limit special provisions to small employers only. Thus, some argue that exceptions for small employers should be adopted only if it is appropriate from a policy perspective to eliminate nondiscrimination rules for all employers.

Eligibility rules

The proposals amending the eligibility requirements for SEPs would conform the rules for SEPs more closely to the rules relating to qualified plans and thus may operate to simplify the pension system generally. On the other hand, such rules require employers to keep track of actual hours worked by employees, which may increase the recordkeeping burdens imposed on small employers.

A one-year of service rule permits an employer to require that an employee complete 1,000 hours of service (or work approximately 20 hours per week) in order to qualify for a contribution on the employee's behalf to the employer's pension plan. Long-term, part-time employees would be entitled to a contribution under present law. To the extent that employees of small employers work on a periodic or part-time basis, however, the change to a one-year of service requirement may reduce the number of employees covered by a pension plan.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
2. **Repeal of limitation on ability of State and local governments and tax-exempt employers to maintain cash or deferred arrangements**	Except with respect to plans established before certain dates, State and local governments and tax-exempt employers are generally prohibited from maintaining qualified cash or deferred arrangements (section 401(k) plans). Some of these employers may be allowed under present law to maintain similar arrangements, such as tax-sheltered annuity programs or section 457 plans.	The bill allows State and local governments and tax-exempt organizations to maintain qualified cash or deferred arrangements.	Same as H.R. 2730.	No provision.	The bill allows nongovernmental tax-exempt organizations to maintain cash or deferred arrangements.
		Effective date.--In the case of tax-exempt organizations, the provision applies to years beginning after December 31, 1991. In the case of governmental employers, the provision applies to years beginning after December 31, 1994.	Effective date.--No specific date provided.		Effective date.--The provision applies to years beginning after December 31, 1989.

DISCUSSION

The present-law restrictions on the maintenance of cash or deferred arrangements by governmental and tax-exempt employers means that many such employers cannot maintain broad-based retirement programs that permit their employees to save on a pre-tax basis. From a tax policy perspective, there is no strong reason why such plans should not be available to employees of tax-exempt and governmental employers on the same basis that they are available to employees of taxable private employers.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
3. Duties of master and prototype plan sponsors	The IRS master and prototype program is an administrative program under which trade and professional associations, banks, insurance companies, brokerage houses, and other financial institutions can obtain IRS approval of model retirement plan language and then make these preapproved plans available for adoption by their customers, investors, or association members. Rules regarding who can sponsor master and prototype programs, the prescribed format of the model plans, and other matters relating to the program are contained in revenue procedures and other administrative pronouncements of the IRS. The IRS also maintain related administrative programs that authorize advance approval of model plans prepared by law firms and others, e.g., the regional prototype plan program and volume submitter program.	The bill authorizes the IRS to define the duties of organizations that sponsor master and prototype, regional prototype, and other preapproved plans. It is also intended that the Secretary could relax the rules prohibiting cutbacks in accrued benefits when an employer replaces an individually-designed plan with a preapproved plan. Effective date.--The provision is effective upon enactment.	Generally the same as H.R. 2730.	No provision.	No provision.

DISCUSSION

Increased use of the IRS preapproved plan system would relieve administrative burdens on many employers with respect to keeping up to date with changes in pension laws and regulations. The preapproved plan system is an administrative program, and thus, legislative authorization is not necessarily required in order for the IRS or Treasury to make changes to the program.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
C. Nondiscrimination Provisions					
1. Nondiscrimination rules relating to qualified cash or deferred arrangements, matching contributions, and after-tax employee contributions					
a. Qualified cash or deferred arrangements	Under a qualified cash or deferred arrangement, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee or to the employee directly in cash. The maximum annual amount of such elective deferrals that can be made by an individual is $8,475 for 1991. Under a special nondiscrimination test applicable to qualified cash or deferred arrangements, the actual deferral percentage (ADP) for eligible nonhighly compensated employees for a plan year must be equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement, or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage points. The ADP for a group of employees is the average of the ratios (calculated separately for each employee in the group) of the contributions paid to the plan on behalf of the employee to the employee's compensation.	The bill replaces the present-law two-prong ADP test with a single test that is applied at the beginning of the plan year. Under the bill, the maximum amount each eligible highly compensated employee can defer is 200 percent of the average deferral percentage of nonhighly compensated employees for the preceding plan year. The average deferral percentage of nonhighly compensated employees is determined the same way as the ADP for such employees under present law. In the case of the first plan year of a qualified cash or deferred arrangement, the average deferral percentage for nonhighly compensated employees for the previous year is deemed to be 3 percent or, at the election of the employer, the average deferral percentage for the plan year. The bill also eliminates the recharacterization method as a means of correcting failures to meet the special nondiscrimination test.	Generally the same as H.R. 2730, except that a different formula is used in determining the maximum amount each highly compensated employee can defer.	The bill adds an alternative safe harbor method of satisfying the special nondiscrimination test for qualified cash or deferred arrangements. Under the bill, the nondiscrimination test is deemed to be satisfied if the employer either (1) makes a matching contribution on behalf of each nonhighly compensated employee of at least (a) 100 percent of the employee's elective contributions up to 3 percent of compensation or (b) 50 percent of the employee's elective contributions up to 6 percent of compensation, or (2) makes a nonelective contribution to a defined contribution plan of at least 3 percent of each nonhighly compensated employee's compensation, without regard to whether the employee elects to contribute to the cash or deferred arrangement. The matching contributions and the nonelective contributions must be 100-percent vested. In addition, the employer is required to notify employees of the employees' rights and obligations under the arrangement. The bill also modifies the	Same as H.R. 2641, except that the matching contribution prong of the safe harbor is satisfied if the employer makes a matching contribution of 100 percent of the elective contribution of the employee to the extent such contributions do not exceed 3 percent of the employee's compensation and 50 percent of the elective contributions to the extent that such contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation. The bill does not contain the provision in H.R. 2641 that provides that the preceding year ADP for nonhighly compensated employees is used in applying the ADP test.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	If the special nondiscrimination rule is not satisfied for any year, the qualified cash or deferred arrangement will not be disqualified if the excess contributions (plus income) are distributed before the close of the following plan year. In addition, under Treasury regulations, an employer may elect to have the excess contributions treated as an amount distributed to the employee and then contributed by the employee to the plan on an after-tax basis. The excess contributions attributable to each highly compensated employee are determined by reducing the ADP of highly compensated employees, beginning with the employees with the highest ADP, until the special nondiscrimination test is satisfied. A 10-percent excise tax is imposed on an employer making excess contributions which are not distributed or recharacterized as after-tax employee contributions within 2-1/2 months after the close of the plan year to which the excess contributions relate.			method of determining excess contributions under the ADP test. Under the bill, excess contributions are allocated among highly compensated employees beginning with the employees with the highest dollar amount of contributions. The bill provides that the ADP test is applied by using the ADP for nonhighly compensated employees for the prior year, rather than the current year as under present law. In the case of the first plan year, the current year's ADP is used.	
b. Employer matching contributions and after-tax employee contributions	A special nondiscrimination test is applied to employer matching contributions and after-tax employee contributions that is similar to the special nondiscrimination test applicable to elective deferrals under qualified cash or deferred arrangements. The special	The bill conforms the special nondiscrimination test for employer matching and after-tax employee contributions to the rules under the bill regarding qualified cash or deferred arrangements. Thus, under the bill, a plan meets the special nondiscrimination test if the actual contribution	The proposal conforms the special nondiscrimination test for employer matching contributions and after-tax contributions to the rules under the proposal for qualified cash or deferred arrangements.	Under the bill, the special nondiscrimination test for employer matching and after-tax employee contributions is deemed satisfied if (1) the plan meets the nonelective contribution or matching contribution requirements applicable to the cash or deferred arrangement	Same as H.R. 2641, except that the safe harbor applies only to employer matching contributions (not after-tax employee contributions), and the 10-percent limit on after-tax contributions by highly compensated employees does not apply.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	nondiscrimination test is satisfied for a plan year if the contribution percentage for eligible highly compensated employees does not exceed the greater of (1) 125 percent of the contribution percentage for all other eligible employees, or (2) the lesser of 200 percent of the contribution percentage for all other eligible employees or such percentage plus 2 percentage points. Rules similar to the rules applicable to excess deferrals apply to the disposition of excess matching and after-tax contributions.	percentage for each highly compensated employee does not exceed 200 percent of the average contribution percentage of nonhighly compensated employees for the prior year.		safe harbor, (2) employees are notified of the plan, (3) matching contributions are not made with respect to employee contributions or elective deferrals in excess of 6 percent of compensation, and (4) after-tax contributions by highly compensated employees do not exceed 10 percent of the employee's compensation for the year.	
		Effective date.--Plan years beginning after December 31, 1991.	Effective date.--None specified.	Effective date.--Years beginning after December 31, 1991.	Effective date.--Years beginning after December 31, 1991.

DISCUSSION

The sources of complexity generally associated with the nondiscrimination requirements for qualified cash or deferred arrangements and matching contributions are the recordkeeping necessary to monitor employee elections, the calculations involved in applying the tests, and the correction mechanism, i.e., what to do if the plan fails the tests. None of these factors is new -- some form of the nondiscrimination test has been in the law since 1978. Changes to these rules made by the Tax Reform Act of 1986 may have added to the complexity of the rules in operation.

The Tax Reform Act narrowed the permitted disparity between contributions by highly compensated employees and contributions by nonhighly compensated employees. Plans that previously passed the nondiscrimination tests may not meet the Tax Reform Act rules, thereby placing more focus on the nondiscrimination rules themselves, as well as on the procedures for correcting failures to satisfy the rules. The Tax Reform Act also imposed a separate dollar limitation on annual elective deferrals of employees ($8,475 for 1991); some believe that this dollar limitation obviates the need for nondiscrimination tests or obviates the need for nondiscrimination tests based on actual utilization of the cash or deferred arrangement. However, the dollar cap on elective deferrals limits the deferrals of highly compensated employees, but does not, by itself, ensure that there is adequate participation in the arrangement by rank-and-file employees.

The Tax Reform Act also added the special nondiscrimination rules for employer matching contributions and after-tax employee contributions. These rules added a new layer of testing and, therefore, of complexity for qualified cash or deferred arrangements (called section 401(k) plans), because an employer match is typically a part of such arrangements.

The changes made in the Tax Reform Act of 1986 were enacted because Congress was concerned that the rules relating to qualified cash or deferred arrangements encouraged employers to shift too large a portion of the share of the cost of retirement savings to employees. Congress was also concerned that the nondiscrimination rules permitted significant contributions by highly compensated employees without comparable participation by rank-and-file employees, a result that some believe is inconsistent with a basic reason for extending favorable tax treatment to employer-provided pension plans.

On the other hand, some argue that the complexity of the nondiscrimination requirements, particularly after the Tax Reform Act imposed a dollar cap on elective deferrals, is not justified by the marginal additional participation of rank-and-file employees that might be achieved by the operation of these requirements. Some argue that the rate of rank-and-file employee participation in cash or deferred arrangements is more directly related to the age of the employee than to the employee's compensation and that the nondiscrimination rules do not take this factor into account. They believe that the failure of young employees, who are more likely to be nonhighly compensated, to make elective deferrals should not restrict the ability of older employees to contribute to their retirement savings. Further, the definition of a highly compensated employee may include some middle-income taxpayers for whom adequate retirement savings is essential and the operation of the nondiscrimination rules may prevent such an employee from saving.

Some believe that the Tax Reform Act unnecessarily restricted the ability of highly compensated employees to save for retirement. The fact that the Federal Government waived the application of nondiscrimination requirements to the cash or deferred arrangement maintained for Federal employees is often cited as a justification for the repeal of the special nondiscrimination test for all employers. In addition, some argue that the result that the nondiscrimination rules is intended to produce can also be achieved by creating an incentive for employers to provide matching contributions on behalf of rank-and-file employees. Matching contributions, it is argued, create a sufficient inducement to rank-and-file employee participation.

Some practitioners have suggested that the present-law nondiscrimination tests should be eliminated or replaced with a design-based test. Under a design-based test, a plan is nondiscriminatory if it is designed in a certain way. Some people have serious tax and retirement policy concerns with a test that is not based on actual contributions and would argue that such a test permits cash or deferred arrangements to operate essentially like an individual retirement arrangement (IRA) with a much higher contribution limit. This type of IRA-equivalent arrangement is only available to employees whose employers offer such a plan. Thus, some argue that the absence of nondiscrimination rules based on actual utilization would cause the Federal tax laws to treat similarly situated taxpayers differently.

Some believe that a test based on actual participation is the best way to prevent elective plans from disproportionately benefiting high-paid employees and the only way to ensure that low-paid employees actually benefit under the plan. The ADP tests provide an incentive for employers to encourage the participation by low-paid employees. It is argued that special nondiscrimination rules are necessary in the case of elective plans because higher-income employees naturally are in a position to defer greater amounts of income than lower-paid employees. Indeed, if an elective plan is the employee's only retirement plan, lower-income employees may not have sufficient disposable income to provide sufficient retirement income. For this reason, some believe that elective retirement plans do not operate as efficiently as nonelective plans from a retirement policy perspective.

However, some argue that the adoption of a design-based nondiscrimination test for cash or deferred arrangements and matching contributions will promote expanded coverage for rank-and-file employees. The adoption of a nondiscrimination safe harbor that eliminates the testing of actual contributions to the plan

removes a significant administrative burden that may act as a deterrent to employers who would not otherwise set up such a plan. Thus, the adoption of a simpler nondiscrimination test may encourage more employers, who do not now provide any tax-favored retirement plan for their employees, to establish a plan. However, some argue that the rapid rate of establishment of cash or deferred arrangements is inconsistent with arguments that the nondiscrimination requirements act as a deterrent to employers to set up such plans. The bills which include design-based safe harbors address concerns that rank-and-file employees may not participate by requiring a certain level of employer contributions (either nonelective or matching). These contributions provide an incentive for lower-paid employees to contribute. In addition, the bills assure that lower-paid employees will be aware of the plan by requiring employers to communicate the plan to employees.

In addition, a design-based nondiscrimination test provides certainty to an employer that does not exist under present law. Under such a test, an employer will know at the beginning of each plan year whether the plan satisfies the nondiscrimination requirements for the year. There are alternative ways to achieve this result, such as the approach taken in H.R. 2730.

Under H.R. 2641 and H.R. 2742, the design-based nondiscrimination tests are provided as alternatives to the present-law nondiscrimination tests. The addition of optional methods of satisfying the nondiscrimination requirements for cash or deferred arrangements may be perceived by some employers as adding, rather than reducing, the complexity of the requirements because employers will want to determine which test is best for them.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
2. Modification to definition of leased employee	An individual (a leased employee) who performs services for another person (the recipient) may be required to be treated as the recipient's employee for various employee benefit provisions if the services are performed pursuant to an agreement between the recipient and a third person (the leasing organization) who is otherwise treated as the individual's employer. The individual is to be treated as the recipient's employee only if the individual has performed services for the recipient on a substantially full-time basis for a year, and the services are of a type historically performed by employees in the recipient's business field.	The present-law "historically performed" test is replaced with a new rule defining who must be considered a leased employee. Under the bill, an individual is not considered a leased employee unless the services are performed under any significant direction or control of the service recipient.	No provision.	The bill replaces the "historically performed" test with a "control" test. Under the bill, a person is not a leased employee of a service recipient unless the recipient exercises primary control over the manner in which the services are performed.	The bill replaces the "historically performed" test with a "control" test. Under the bill, a person is not a leased employee unless the services are performed under the control of the recipient.
		Effective date.--The provision is effective for years beginning after December 31, 1991. In applying the leased employee rules to years beginning before such date, it is intended that the Secretary use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse. The changes to the leasing rules are not intended to affect grandfather rules granted under prior legislation.		Effective date.--The provision applies to taxable years beginning after December 31, 1983. If, without regard to the bill, a plan met the qualification requirements of the Code for years beginning after December 31, 1983, and before January 1, 1992, such plan will not fail to be treated as meeting such requirements by reason of the fact that any individual who is treated as a leased employee without regard to the bill ceases to be so treated by reason of the bill.	Effective date.--The provision applies to taxable years beginning after December 31, 1983.

DISCUSSION

The leased employee rules are designed to prevent circumvention of the pension plan qualification rules. The coverage and nondiscrimination rules operate by comparing an employer's highly compensated employees and nonhighly compensated employees. The possibility of discrimination in favor of highly compensated employees increases to the extent that an employer can reduce the number of individuals required to be counted as nonhighly compensated employees through arrangements such as leasing. For example, one obviously abusive type of transaction that Congress was concerned about in enacting the leasing rules were cases in which a professional would fire his or her staff and then rehire the same people through a leasing organization. The former employees would no longer be considered employees of the professional, enabling the professional to set up a generous qualified plan that covered only himself or herself.

Avoidance of the qualification rules through employee leasing is possible because the common-law rules for determining who is the employer of an individual are concerned primarily with who is the appropriate party from whom to collect withholding taxes and, in some cases, for determining whether or not an individual is an employee or an independent contractor. The same factors that are relevant to such a determination are not necessarily those that are most relevant in determining those situations which undermine the pension rules.

The primary concern articulated with respect to the present-law rules is that the statute, as interpreted by proposed regulations, is overly broad and counts as leased employees individuals who should not be considered such. There is also some concern that it is difficult to obtain the information necessary to determine who is a leased employee because some of the information is obtainable only from a third party and is not readily accessible by the employer.

The extent to which statutory changes can clarify the application of the leased employee rules may be limited because the determination of whether someone should be a leased employee in inherently factual in nature. It depends on the underlying relationship of the parties, and may also depend on whether the situation involves abuse of the pension rules, factors that will vary on a case-by-case basis. Thus, ultimately what may be necessary is some statutory change with direction in the legislative history as to the kinds of circumstances that the Congress believes should and should not result in someone being considered a leased employee. Although exact clarity may not be possible in all cases because of the factual nature of the rules, some certainty can be provided.

Each of the proposals adopts similar statutory language. To some extent, the differences in the formulation of the statutory language may not be as critical as the legislative history because much of the leasing rules depends on administrative interpretation. However, one issue that has been raised with respect to a "control" standard is that using a control test in the leased employee area may create confusion as employers and practitioners try to distinguish it from the control test used to determine whether an individual is a common law employee. Leased employees are by definition individuals who, under the common-law test, are not employees. Use of similar terms without clarification of their meaning can create administrative problems for employers and enforcement problems for the IRS. Thus, statutory language that clearly distinguishes the leased employee definition from the common-law test may be preferable.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
3. Definition of highly compensated employee	An employee is highly compensated if: (1) at any time during the preceding year, the employee (a) was a 5-percent owner, (b) earned more than $85,485, (c) earned more than $56,990 and was in the top-paid 20 percent, or (d) was an officer and earned more than $51,291; or (2) during the current year, the employee is (a) a 5-percent owner or (b) is one of the 100 employees paid the greatest compensation for the year and (i) earns more than $90,803, (ii) earns more than $60,535 and is in the top-paid 20 percent, or (iii) is an officer and earns more than $54,482. If no officer is treated as being highly compensated under these rules, the highest paid officer is treated as highly compensated. All dollar values are indexed for inflation. Employers that maintain significant operations in at least 2 separate geographic locations may use a simplified method under which an employee is highly compensated if: (1) at any time during the preceding year, the employee (a) was a 5-percent owner, (b) earned more than $85,485, or (c) was an officer and earned more than $51,291; or (2) during the current year, the employee (a) is a 5-percent owner, (b) earns more than $90,803, or (c) is an officer and earns more than $54,482. All dollar values are indexed. Under both the normal and simplified methods, if an employee is a family member of	The bill provides that an employee is highly compensated if: (1) at any time during the preceding year, the employee was a 5-percent owner or earned more than $65,000; or (2) during the current year, the employee is a 5-percent owner or is in the top 100 employees by compensation and earns more than $65,000. If no employee is treated as highly compensated, the highest paid employee is treated as highly compensated. The $65,000 dollar figure is indexed for inflation (thus, as under present law, the dollar thresholds will differ for the lookback year and the current year). If an employee is a family member of a 5-percent owner, the employee and the family member are treated as one highly compensated employee. Family members include the spouse and lineal descendants of the employee who are under age 19.	Same as H.R. 2730, except that the rules requiring aggregation of family members are repealed.	The bill provides that an employee is highly compensated if: (1) at any time during the preceding year, the employee was a 5-percent owner; or (2) during the current year, the employee (a) is a 5-percent owner or (b) receives compensation in excess of $60,535. The $60,535 figure is indexed for inflation. If the employer elects, an employee's compensation for the preceding year rather than the current year may be used to determine if the employee's compensation exceeds the compensation threshold. Once made, the election is irrevocable without the consent of the Secretary. If no employee is treated as highly compensated under these rules, the highest paid employee is treated as highly compensated, except that no employee will be considered highly compensated for purposes of applying the nondiscrimination requirements applicable to qualified cash or deferred arrangements (sec. 401(k)) and employer matching and after-tax employee contributions (sec. 401(m)). The bill repeals the rule aggregating family members.	The bill provides that an employee is highly compensated if: (1) at any time during the preceding year the employee was a 5-percent owner; or (2) during the current year, the employee (a) is a 5-percent owner or (b) receives compensation in excess of $60,535. The $60,535 is indexed for inflation. If no employee is treated as highly compensated under these rules, the highest paid officer is treated as highly compensated, except that no employee will be considered highly compensated (1) for purposes of applying the nondiscrimination requirements applicable to qualified cash or deferred arrangements (sec. 401(k)) and employer matching and after-tax employee contributions (sec. 401(m)) and (2) for plans maintained by State and local governments and tax-exempt organizations. If an employee is a family member of a 5-percent owner, the employee and the family member are treated as one highly compensated employee. There is no change in the definition of family member.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	either a 5-percent owner or one of the top 10 most highly compensated employees, the employee and the family member are treated as one highly compensated employee. Family members include the spouse, lineal ascendants or descendants, and spouses of a lineal ascendant or descendant of the employee.				
		Effective date.--Years beginning after December 31, 1991.	Effective date.--None specified.	Effective date.--Years beginning after December 31, 1991. An employer may elect not to have the amendments made by this provision apply to years beginning in 1992.	Effective date.--Years beginning after December 31, 1991. An employer may elect not to have the amendments made by this provision apply to years beginning in 1992.

DISCUSSION

Many of the nondiscrimination requirements that apply to qualified pension plans focus on comparisons between the treatment under a plan of an employer's highly compensated employees and the employer's nonhighly compensated employees. For example, a qualified retirement plan may not discriminate in favor of highly compensated employees in the amount of contributions or benefits provided under the plan. Significant pressure exists to utilize a definition of highly compensated employee that properly identifies those employees who are among the most highly compensated employees of an employer, but that does not impose unwarranted administrative burdens.

Under present law, the various categories of highly compensated employees require employers to perform a number of complex calculations that for many employers have largely duplicative results. Furthermore, some employers argue that the present-law standards are imprecise and difficult to administer. For example, to determine whether an employee is an officer requires a subjective evaluation of each potential officer's status (both in name and authority), including the source of the officer's authority, the term of office, and the nature of the officer's duties. Employers also argue that a test based on the top percentage of employees by compensation (i.e., the top 20-percent rule) is difficult to administer, especially because they must determine this status for the current year and the preceding year. As any employee enters or leaves the work force, it affects the calculation, possibly changing the employees who are in the top 20-percent. These problems are exacerbated for larger employers with employees at many locations and on multiple payrolls.

The bills address these complaints by consolidating the rules used to determine which employees are highly compensated, focusing on whether an employee's compensation or ownership percentage exceed established thresholds that are the same for all employers. Proponents of this approach point to its simplicity and ease of administration. Critics argue that, while simple, a test that establishes a compensation threshold that applies to all employers may not always identify the group of employees for any particular employer in

favor of whom discrimination (or any of the other standards) should be prohibited. These people argue that a test based on the top percentage of employees by compensation more accurately identifies the relevant high-paid group for any particular employer.

For example, under the bills, a company all of whose employees earn less than the compensation threshold will have only one highly compensated employee (under the special rule that deems the highest paid employee or officer to be highly compensated), even if all of the officers of the company receive compensation just under the dollar threshold while rank-and-file employees earn significantly less. In this case, the employer could maintain a qualified plan solely for the benefit of its officers (other than the one deemed to be highly compensated), excluding all of the rank-and-file employees. At another company, there may be a large number of employees who earn more than the compensation threshold, even though only a small group of employees actually manage the company. In this case, the company could provide benefits to all of the management employees and a small proportion of rank-and-file employees and provide no benefits at all to the large group of nonmanagement employees who earn more than the compensation threshold. Under a test based on the top percentage of employees by compensation, such discrimination would be prohibited.

With regard to family members, some question whether family members of certain highly compensated employees should be considered highly compensated. They point out that in a large corporation or a controlled group with many diversified businesses, employers are forced to determine whether a family member of any highly compensated employee is also an employee of the employer. They suggest that the recordkeeping burden is extremely difficult. H.R. 2641 and the Administration proposal address this complaint by eliminating the aggregation rule in all cases, while H.R. 2730 and H.R. 2742 maintain the rule only for 5-percent owners, who generally are very few in number and easily identifiable.

There is disagreement among pension experts over what the appropriate testing period should be to determine if an employee is highly compensated. Proponents of H.R. 2742 argue that it is generally inappropriate to include the year for which the test is applied in the testing period when testing compensation. They suggest that a test including the current year makes it difficult to finally identify the highly compensated group before the last day of the plan year, thus making it difficult to determine coverage for the year. They favor using a lookback period that ignores the current year and ends instead on the last day of the preceding plan year. This would fix the highly compensated group at the beginning of the year, making it easier to comply with the coverage requirements without requiring employers to monitor employee changes within the current year. The testing period for five percent ownership can include the current year because ownership generally does not vary significantly from year to year.

Proponents of H.R. 2730 argue, on the other hand, that it is important to match the identification of highly compensated employees with the current work force. They believe it is appropriate to require consideration of the current year. They also point out that if the current year is ignored, a newly hired employee who otherwise would be considered highly compensated could receive very large accruals in that first year. Including the employee in the highly compensated group in the second year of his or her employment would not correct this discriminatory accrual. This criticism can also be made of the Rostenkowski bill, however, because new employees will be considered highly compensated in their first year only if they are in the top 100 employees by compensation.

H.R. 2641 allows an employer to make a one-time election to select as a testing year either the current year or the preceding year for purposes of testing compensation. Five percent owners in either the preceding or current year would be considered highly compensated.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
1. Nondiscrimination, coverage, and participation					
a. Nondiscrimination testing based on average rate of accruals	A qualified plan cannot discriminate in favor of highly compensated employees in the amount of contributions or benefits provided under the plan (sec. 401(a)(4)). Under proposed Treasury regulations, whether a plan is nondiscriminatory is determined on an individual basis, so that a plan is nondiscriminatory only if no highly compensated employee in the plan has an allocation rate or accrual rate that exceeds that of any nonhighly compensated employee in the plan. A plan is not discriminatory merely because benefits or contributions equal the same percentage of compensation for each participant under the plan.	No provision.	No provision.	The bill provides that a plan is deemed to be nondiscriminatory under Code section 401(a)(4) if the average rate of accrual for highly compensated employees is not greater than the average rate of accrual for all other employees.	No provision.
b. Social security supplements	Under proposed Treasury regulations, social security supplements may not be taken into account in testing whether benefits are nondiscriminatory under the general nondiscrimination rule (sec. 401(a)(4)). Social security supplements are not protected by the rules prohibiting cutbacks in accrued benefits.	No provision.	No provision.	The bill provides that social security supplements may be taken into account in testing most valuable accruals for purposes of the general nondiscrimination rule, provided these supplements are subject to the anticutback rules. Social security supplements are disregarded in testing permitted disparity for purposes of the rules relating to social security integration.	No provision.
c. Transfer of employees	Under proposed Treasury regulations, a qualified retirement plan does not satisfy the general nondiscrimination	No provision.	No provision.	The bill provides that a plan is not discriminatory merely because the plan provides that the benefits of	No provision.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	rule if plan provisions that provide credit for past service with the employer or a related employer have the effect of discriminating significantly in favor of highly compensated employees. For example, if only highly compensated employees at a company have worked for a related employer, a provision giving extra benefits based on service with related employers might be considered discriminatory.			employees who transfer between members of the plan sponsor's controlled group, or between different employee groups within the employer, are based on all years of service with the employer and are offset by the benefit accrued under any other plan or plans of the employer.	
d. Special grandfather rule for integrated plans	Benefits are not considered discriminatory merely because they are integrated with social security benefits, within limitations prescribed by the Code. The Tax Reform Act of 1986 modified the permitted disparity under the integration rules, generally effective for benefits accruing after December 31, 1988.	No provision.	No provision.	The bill provides that a defined benefit plan with benefits based on a final average pay formula may use the prior-law integration formula for benefits accrued as of the last plan year ending on or before December 31, 1988, but based on employees' final average pay at retirement age (rather than average pay as of the end of 1988). This permits a larger fraction of benefits to be computed under the prior-law integration rules.	No provision.
e. Definition of compensation	The Code specifies a definition of compensation that is used for purposes of many of the qualified plan rules (e.g., nondiscrimination) (sec. 414(s)). This definition generally includes all taxable compensation of an employee. The Secretary may, by regulation, provide alternative definitions of compensation that do not result in discrimination in favor of highly compensated employees. The Treasury Department has issued	No provision.	No provision.	The bill modifies the Secretary's authority to provide alternative definitions of compensation by specifically providing that an acceptable definition is an employee's basic or regular rate of compensation.	The bill provides that an employer may elect to define compensation as an employee's base pay. This election must apply to all employees of the employer, and may be revoked only with permission of the Secretary.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	regulations providing for such alternative definitions.				
f. Separate line of business rules	An employer that operates separate lines of business may apply the minimum coverage and nondiscrimination rules separately with respect to employees in each separate line of business. An employer is not treated as operating separate lines of business unless the plan benefits a classification of employees that is not discriminatory in favor of highly compensated employees on an employer- wide basis (the reasonable classification test). An employer's headquarters may not be treated as a separate line of business. Rather, headquarters employees must be allocated among the lines of business of the employer. In determining how to allocate head- quarters personnel among its various lines of business, an employer must determine which employees perform substantial services for each line of business.	No provision.	No provision.	The bill permits an employer to apply the reasonable classification test with respect to employees in each line of business rather than on an employer-wide basis. The bill provides a safe-harbor allocation method for headquarters employees, under which an employer may elect to treat its headquarters as a separate line of business and allocate all headquarters employees to such separate line of business if at least 60 percent of the headquarters employees are not highly compensated employees. A headquarters employee is defined for this purpose as any employee who performs no more than 50 percent of his or her services for any one line of business. The Secretary is directed to write rules reducing the 60-percent threshold if the number of headquarters employees who are highly compensated is less than 85 percent of the highly compensated employees of the employer.	No provision.
g. Inclusion of union employees for coverage testing	Employees covered by a collective bargaining agreement are excluded from consideration in testing whether a qualified retirement plan satisfies the minimum coverage and nondiscrimination tests. In addition, such employees may not be counted for purposes of determining whether a line of business has 50 employees, the	No provision.	No provision.	The bill provides that an employer can elect to include unionized employees who benefit under the plan on the same terms as other employees in testing whether a plan satisfies the minimum coverage and nondiscrimination tests, and to count such employees for purposes of the separate line of business rule requiring at least	No provision.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	threshold number for designating a unit as a separate line of business for purposes of applying the coverage and nondiscrimination tests. The separate testing and exclusion rules are mandatory; an employer may not elect to include unionized employees in testing a plan covering employees not covered by a collective bargaining agreement.			50 employees.	
h. Special coverage rule for airline pilots	In the case of a plan established pursuant to a collective bargaining agreement between airline pilots and one or more employers, all employees not covered under the agreement are excluded from consideration in testing whether the plan covering the union airline pilots satisfies the minimum coverage and nondiscrimination tests.	The bill extends the present-law treatment of plans maintained for union pilots to plans maintained for nonunion pilots who are employed by one or more common carriers or by carriers transporting mail for, or under contract with, the United States Government.	No provision.	No provision.	No provision.
i. Minimum participation rule	A plan generally may not benefit fewer than the lesser of 50 employees or 40 percent of all employees of the employer. This test must be met on each day of the plan year. In the case of an employer with only 2 employees, a plan satisfies the rule if it covers 1 employee.	No provision.	No provision.	The bill provides that the minimum participation rule applies only to defined benefit plans (not defined contribution plans). A plan may benefit no fewer than the lesser of 25 employees or 40 percent of all employees of the employer. However, a plan maintained by an employer with only 2 employees must cover both. This test can be applied on 1 testing day if the day is represen- tative of the employer's work force and the plan's coverage.	Same as H.R. 2641, except that the test must be met on each day of the plan year.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
Effective dates for miscellaneous provisions				Effective date.--Years beginning after December 31, 1991. An employer may elect to apply the provision modifying the minimum participation rule as if included in the Tax Reform Act of 1986.	Effective date.--Years beginning after December 31, 1991. An employer may elect to apply the provision modifying the minimum participation rule as if included in the Tax Reform Act of 1986.

DISCUSSION

Nondiscrimination testing based on average accruals

A qualified retirement plan must not discriminate in favor of highly compensated employees in the amount of contributions or benefits provided under the plan (sec. 401(a)(4)). A plan need not show that both the contributions and benefits are nondiscriminatory in amount, but only that either the contributions alone or the benefits alone are nondiscriminatory in amount. Under regulations proposed by the Secretary, contributions under a plan generally are nondiscriminatory in amount only if no highly compensated participant has an allocation rate that exceeds that of any nonhighly compensated participant. Similarly, benefits provided under a plan generally are nondiscriminatory in amount only if no highly compensated participant has an accrual rate that exceeds the accrual rate for any nonhighly compensated participant. Under proposed Treasury regulations, the rigors of the rule would be ameliorated by permitting plan sponsors to test their plans on a restructured basis.

H.R. 2641 permits nondiscrimination testing based on an average basis. Under the bill, as long as the average rate of accrual for highly compensated participants does not exceed the average rate of accrual for nonhighly compensated participants, the plan is nondiscriminatory. This applies to testing of benefits and contributions (when testing contributions, the average allocation rate of highly compensated participants may not exceed the average allocation rate of nonhighly compensated participants). Proponents of the averaging approach point to the harshness of the individual approach. If even one highly compensated employee accrues a benefit that is greater than that of a nonhighly compensated employee in the plan, the plan is considered discriminatory -- even if all of the other highly compensated employees in the plan accrue a benefit that is much less generous than the benefits accrued by nonhighly compensated employees. Proponents also argue that Congress has already given its approval to testing based on averages in the rules governing qualified cash or deferred arrangements (sec. 401(k)) and employer matching contributions (sec. 401(m)). Finally, they point out that a test based on average rates does not decrease the benefits received by nonhighly compensated employees -- the aggregate amount of benefits received by nonhighly compensated employees would be the same whether discrimination was tested on an average or individual basis.

Proponents of the individual testing approach argue that the use of average accrual rates permits some highly compensated employees to have much higher accrual rates (as a percentage of pay) than rank-and-file employees. They also suggest that it may be inappropriate to provide tax subsidies to a qualified plan unless every rank-and-file employee that is a participant in the plan receives a benefit under the plan that is at least as great (as a percentage of pay) as the benefits received by the highly compensated employees in the plan -- under an average approach, a rank-and-file participant may not accrue any benefit at all. (One way to prevent

this, while still allowing some use of averaging, would be to require that each rank-and-file participant receive a benefit at least as great as the average benefit received by the highly compensated employees).

Transfer of employees

H.R. 2641 allows plans to grant past service credits for service with a related employer to all participants under the plan. Proponents of this provision argue that it promotes portability. Opponents argue that if past service credits promote portability only for highly compensated employees, they are discriminatory. This may occur, they argue, if most employees who transfer from a related employer are highly compensated.

Special grandfather rule for integrated plans

H.R. 2641 provides a grandfather rule that allows plans to use the integration formula in effect before the Tax Reform Act of 1986 for benefits accrued before the effective date of the 1986 Act, but based on compensation on the date of retirement for service with a related employer. Opponents of this provision argue that it increases the permitted disparity between benefits received by highly compensated employees and nonhighly compensated employees.

Definition of compensation

H.R. 2641 and H.R. 2742 increase the number of permitted definitions of compensation employers may use for nondiscrimination testing purposes. H.R. 2641 gives the Secretary authority to allow the use of an employee's basic or regular rate of pay (e.g., $10 an hour), and H.R. 2742 allows the use of an employee's base pay. Proponents argue that allowing these definitions simplifies nondiscrimination testing because they permit employers to use the compensation tracked by the employer, rather than making the employer maintain special records for testing purposes. Opponents argue that the compensation used for plan testing purposes should be actual pay, not approximations thereof.

Separate line of business rules

H.R. 2641 modifies the rules for determining whether an employer maintains separate lines of business to which the minimum coverage and nondiscrimination rules may be separately applied. The bill permits employers to avoid the present-law requirement that a plan satisfy the reasonable classification requirement (or, under proposed regulations, the 70-percent ratio test) on an employer-wide basis. Proponents of this provision argue that the present-law rule, especially as interpreted by the Secretary in proposed regulations, does not permit employers to treat a separate line of business as a completely separate entity for plan testing purposes, thus defeating the purpose of the separate line rules. These people argue that the proposed regulations fail to appreciate the extent to which employers operate distinct, separate lines of business and the legitimate nontax motivations for adopting disparate, independent benefit plans for each line. They cite this same argument in support of the rule in H.R. 2641 that allows an employer to treat its headquarters as a separate line of business as long as no more than 60% of the headquarters employees are highly compensated employees.

Others argue that while Congress was concerned about the economic disadvantage that employers could face if the nondiscrimination rules were applied on an employer-wide basis -- for example, in those situations where the level of benefits varies among the employer's separate lines of business for competitive market reasons -- Congress did not intend to give employers a "bye" with respect to the nondiscrimination rules. Thus, Congress required all plans to satisfy a nondiscriminatory classification test on an

employer-wide basis. These people also point out that permitting an employer's headquarters to be treated as a separate line of business permits the employer to provide a richer benefit plan to headquarters employees than to employees in other lines. Because a large proportion of the employer's highly compensated employees may be headquarters employees, this, in effect, permits the employer to discriminate in favor of highly compensated employees.

Inclusion of union employees for coverage testing

H.R. 2641 allows an employer to include employees covered under a collective bargaining agreement when testing whether a plan satisfies the minimum coverage and nondiscrimination tests, if such employees benefit under the plan on the same terms as nonunion employees. Proponents of this provision argue that a plan that benefits both union and nonunion employees on the same terms should not be disqualified merely because many of the nonhighly compensated employees in the plan are members of a union. Opponents argue that the exemption from testing of employees covered under a collective bargaining unit is to give deference to the collective bargaining process. They argue that the union employees may have made wage concessions in order to obtain higher pension benefits and that employers should not be able to take advantage of such concessions outside the bargaining process by using union plans to help plans for higher-paid nonunion employees to pass nondiscrimination tests. Opponents also argue that the provision is simply a weakening of the nondiscrimination rules because employers will only follow the provision when it helps their plans pass nondiscrimination tests.

Special coverage rule for airline pilots

H.R. 2730 extends to plans maintained for certain nonunion air pilots the special treatment afforded plans maintained for union pilots under the minimum coverage rules. Under the bill, in the case of a plan maintained for nonunion pilots employed by a common carrier or mail carrier, employees who are not air pilots are excluded from consideration for purposes of testing the pilot's plan for compliance with the minimum coverage standards. Thus, a plan covering pilots is tested separately for purposes of the minimum coverage tests. Proponents of this provision argue that it removes the disparity of treatment between union and nonunion airline pilots. Opponents argue that there is no justification for providing an exception from the minimum coverage rules for nonunion air pilots -- many of whom are highly compensated employees -- when other groups of highly compensated employees are subject to the rules. They argue that it permits airlines and large mail carriers to discriminate in favor of highly compensated employees.

Minimum participation rule

Both H.R. 2641 and H.R. 2742 provide that the minimum participation rule applies only to defined benefit plans (not defined contribution plans), and lowers the minimum number of employees that must benefit under plans maintained by larger employers from 50 to 25. The bills also provide that a plan maintained by an employer with only 2 employees must cover both employees, rather than just 1 employee as under present law, and H.R. 2641 allows employers to use a singe testing date on which to apply the test. Proponents of these provisions argue that these rules better target the minimum participation rule to apply to the situation it was originally intended to address -- small defined benefit plans -- and simplify testing for all other plans. Opponents argue that lowering the minimum number of employees that must benefit under a plan to 25 permits larger employers (those with more than 62 employees) to maintain smaller plans that may result in greater discrimination in favor of highly compensated employees.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
D. Miscellaneous Pension Simplification					
1. Other core qualification requirements					
a. Definition of retirement age	A qualified plan generally must provide that payment of benefits under the plan must begin no later than 60 days after the end of the plan year in which the participant reaches age 65. Also, for purposes of the vesting and benefit accrual rules, normal retirement age generally can be no later than age 65. The social security retirement age as used for plan qualification purposes is presently age 65. Beginning in the year 2000, it is scheduled to increase gradually so that it is age 66 for persons attaining age 62 in 2005, and age 67 for persons attaining age 62 in 2022 and later years.	The bill replaces age 65 with the social security retirement age as the date by which benefit payments must begin and for purposes of the benefit vesting and accrual rules. Effective date.--Years beginning after December 31, 1991.	No provision.	Same as H.R. 2730. The bill also provides that for purposes of the general nondiscrimination rule the social security retirement age is a uniform retirement age, and subsidized early retirement benefits and joint and survivor annui- ties based on an employee's social security retirement age are treated as being available to employees on the same terms. Effective date.--Years beginning after December 31, 1991.	No provision.
b. Modifications to full funding limitation	An employer may make deductible contributions to a defined benefit pension plan up to the full funding limitation, which is gen- erally defined as the excess of (1) the lesser of (a) the accrued liability or (b) 150 percent of the current liability under the plan, over (2) the value of the plan's assets. The Secretary may adjust the 150 percent figure to take into	The bill provides that an employer may elect to disregard the 150-percent limitation if each plan in the employer's control group is not top-heavy and the accrued liability of active participants is 90 percent of the plan's total accrued liability (the "alternative full funding limitation"). The Secretary is required to adjust the 150-percent full funding	No provision.	The bill provides that multiemployer plans are not subject to the 150 percent of current liability limitation and that an actuarial valuation need only be performed every 3 years in the case of a multiemployer plan.	Same as H.R. 2641.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	account the average age and length of service of the participants in the plan. The Secretary has not exercised this authority. An actuarial evaluation of the plan must be performed at least annually.	limitation (in the manner specified under the bill) for employers that do not use the alternative full funding limit to ensure that the election by employers to disregard the 150-percent limit does not result in a substantial reduction in Federal revenues for any fiscal year. Effective date.--Date of enactment.		Effective date.--Years beginning after December 31, 1991.	Effective date.--Years beginning after December 31, 1991.
c. Vesting in multi-employer plans	Qualified plans generally must conform to a 5-year cliff vesting schedule (i.e., a participant must be 100% vested after 5 years; before that, no vesting is required), or a 3-to-7 year graduated vesting schedule. Multi- employer plans are permitted to have a 10-year cliff vesting schedule.	The bill repeals 10-year cliff vesting for multiemployer plans. Instead, multiemployer plans must comply with vesting schedules applicable to all other qualified plans. Effective date.--The provision applies to plan years beginning on or after the earlier of (1) the later of (a) January 1, 1992 or (b) the date on which the last collective bargaining agreement pursuant to which the plan is maintained expires, or (2) January 1, 1994, with respect to participants with an hour of service after such date.	Same as H.R. 2730. Effective date.--None specified.	No provision.	No provision.
d. Date for adoption of plan amendments	Under regulations, plan amendments to reflect changes in the law gen- erally must be made within the "remedial amendment period." Such period gen- erally ends at the time prescribed by law for filing the income tax return of the employer for the employer's	No provision.	No provision.	The bill provides that if any provision of the bill requires a plan amendment, the amendment is not required to be made before the first plan year beginning on or after January 1, 1993, if (1) during the period after the provision takes effect, the plan is operated in accor-	Same as H.R. 2641.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
	taxable year in which the change in law occurs. However, the plan must be operated in accor- dance with present law at all times, and any plan amendment must apply retroactively to the period following the effective date of the change which it reflects.			dance with the requirements of the provision, and (2) the plan amendment applies retroactively to the provision's effective date.	

DISCUSSION

Definition of retirement age

H.R. 2730 and H.R. 2641 allow the use of the social security retirement age for certain purposes. Some employers use the social security retirement age as the normal retirement age under their qualified plans. Under regulations proposed by the Secretary, however, use of the social security age would not be permitted. Proponents of H.R. 2730 and H.R. 2641 argue that allowing employers to use the social security age simplifies plan administration and conforms the definition to the rule in effect for purpose of the limits on contributions and benefits. H.R. 2641 also permits the use of the social security retirement age for purposes of the nondiscrimination rules.

Modifications to full funding limitation

H.R. 2730 provides an alternative full funding limitation for certain defined benefit plans. Proponents of the alternative limitation point out that Congress gave the Secretary authority to promulgate regulations to adjust the 150-percent of current liability test to take into account the average age (and length of service, if appropriate) of the participants in the plan (weighted by the value of their benefits under the plan). Such an adjustment would permit employers with younger work forces to make larger contributions than would otherwise be allowed under the general rule, to offset the effects of the smaller accruals that generally occur under many defined benefit plans in the early years of employment. Proponents of the statutory change argue that it is appropriate for Congress to provide an alternative full funding limitation because the Secretary has not yet exercised his authority to modify the rule, Opponents argue that because the modification is designed to be revenue neutral, employers who do not benefit from the alternative limitation may in fact be subject to stricter contribution standards than under present law (to offset the revenue loss from employers who can make larger contributions under the alternative limitation). In addition, they argue that the alternative limit makes calculation of the full funding limit more complicated.

H.R. 2641 and H.R. 2742 provide that multiemployer plan are not subject to the 150 percent of current liability full funding limitation and that actuarial valuations of the plan are required only once every 3 years. Proponents of this provision argue that the current liability full funding limit is designed to prevent employers from making plan contributions in excess of the amount needed to fund benefits accrued under the plan merely to obtain current tax deductions. They argue that this is not likely to happen in the case of multiemployer plans because contributing employers generally are not entitled to any excess assets that accumulate in the plan. They further argue that annual valuations are necessary only to apply the current

liability full funding limit. Opponents of the provision point out that there are over funded multiemployer plans and that from a tax-policy perspective there is no reason why multiemployer plans should be allowed to accumulate excess assets. They also argue that annual valuations are necessary even if the 150 percent of current liability limitation does not apply because more current valuations will enable the plan administrator to know more accurately the funding status of the plan, e.g., whether the plan is underfunded.

Vesting in multiemployer plans

H.R. 2730 and the Administration proposal repeal 10-year vesting for multiemployer plans, requiring them to comply with the schedules applicable to all other qualified plans. Proponents of this change argue that the present-law rule prevents some union employees from earning a pension, when they would have if vesting occurred more quickly. Opponents argue that longer vesting schedules in multiemployer plans do not prevent employees from vesting because multiemployer plans often provide that service with all employees contributing to the plan (not just service of related employers) is taken into account for vesting purposes. However, such a service counting rule is not required by law, and not all plans contain such a rule.

Date for adoption of plan amendments

The provisions allowing employers until 1993 to amend their plan documents to reflect changes made by the proposals recognizes that there can be significant administrative burdens in making such amendments. One drawback of allowing an extensive amendment period, however, is that the plan must be operated in compliance with present law from the time of the law's effective date, which may be difficult for the plan administrator if the plan document does not reflect present law. It may also be confusing for plan participants.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
2. Other miscellaneous changes					
a. Cost-of-living adjustments	The qualified plan rules contain a number of dollar limits that are indexed annually for cost- of-living adjustments. Because the adjustments are based on changes as of the last calendar quarter of the preceding year, adjust- ed dollar amounts are not published until after the beginning of the year to which the limits apply. The adjusted dollar amounts are not rounded.	The bill provides that the adjustments with respect to a year is based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding year. Thus, adjusted limits will be published before the beginning of the year to which they apply. Also, dollar limits are generally rounded to the nearest $1,000, except that the limits that relate to elective deferrals and elective contributions to a simplified employee pen- sion plan (SEP) are rounded to the nearest $100.	No provision.	Same as H.R. 2730.	Same as H.R. 2730.
b. Half-year requirements	A number of pension rules refer to the age of an individual at a certain time. Many of these rules are triggered by the attainment of age 70-1/2 (e.g., the minimum distri- bution rules) or age 59-1/2 (e.g., early withdrawal penalty for qualified plans and IRAs).	The bill changes age 70-1/2 to age 70, and age 59-1/2 to age 59.	No provision.	No provision.	Same as H.R. 2730.
c. Plans for self-employed individuals	Most of the disparity between plans maintained by self-employed individuals (Keogh plans) and incor- porated employers has been eliminated. However, certain special aggregation rules apply to plans main- tained by self-employed individuals that do not apply to other qualified plans.	The bill eliminates the special aggregation rule for plans maintained by self-employed individuals.	No provision.	Same as H.R. 2730.	Same as H.R. 2730.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
d. Penalties for failure to file reports of pension and annuity payments	There is a $25 dollar a day penalty, up to a maximum of $15,000, for each failure to file reports (Form 1099R) of pension and annuity payments. The IRS has indicated that all amounts of $1 or more must be reported. This penalty structure is separate from the one governing failure to file pension related returns.	No provision in H.R. 2730, but H.R. 2777 (the Tax Simplification Act of 1991) incorporates into the general penalty structure the penalties for failure to provide information reports to the IRS and to participants relating to pension payments. Generally, the penalty is $50 for each return with respect to which a failure occurs, up to a maximum of $250,000 per year. H.R. 2777 does not require reports of pension and annuity payments of less than $10.	No provision.	Same as H.R. 2777.	Same as H.R. 2777.
e. Contributions for disabled employees	For purposes of the percentage of compensation limit on contributions to a defined contribution plan, contributions on behalf of a disabled employee may be based on the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming disabled. This rule applies only if the participant is not a highly compensated employee and the employer elects to have the rule apply.	No provision.	No provision.	The bill extends present law treatment to disabled highly compensated employees if continuing contributions to the plan are available to all disabled participants. The employer need not make an election to have the special rule apply.	Same as H.R. 2641.
f. Determination of employee contribu-tions under defined benefit plans	For certain purposes, calculation of an employ- ee's benefit attributable to his or her own contribu- tions must be based on an interest rate equal to 120% of the rate on mid-term Treasury bonds.	No provision.	No provision.	The bill provides that the interest rate used for calculating benefits attributable to an employ- ee's contributions equals the rate used by the PBGC in determining the present value of lump sum distri- butions. (This rate is generally based on a basket of rates used for commer- cial annuity contracts.) However, the accrued ben- efit derived	No provision.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
				from employee contributions may not exceed the greater of (1) the employee's accrued benefit under the plan, or (2) the employee's manda- tory contributions to the plan.	
g. VEBA affiliation requirements	Under regulations, membership in a voluntary employees' beneficiary association (VEBA) is limited to individuals with an employment-related common bond. Such a bond is deemed to exist among employees of a "common employer (or affiliated employers)."	No provision.	No provision.	The bill provides that employers are affiliated for purposes of the VEBA requirements under the regulations if (1) the employers are in the same line of business, (2) the employers act jointly to perform tasks that are integral to the activities of each of the employers, and (3) these joint activities are sufficiently extensive that maintenance of a common VEBA is not a major part of such joint activity. This clarification of present law applies retroactively.	Same as H.R. 2641.
h. In-service distri- butions from rural cooperative plans	In general, distri- butions from a cash or deferred arrangement (a 401(k) plan) are permitted upon (1) a participant's separation from service, death or disability, (2) a participant's attainment of age 59-1/2, or (3) hardship (for elective deferrals only). However, distri- butions from a plans main- tained by rural coopera- tives are not permitted because of the attainment of age 59-1/2 or hardship because such plans are pension plans that are generally precluded from making in-service distributions. (Under H.R. 2730 and H.R. 2742, age 59-1/2 would be changed to age 59).	The bill permits distributions from cash or deferred arrangements maintained by rural cooperatives after attainment of age 59.	No provision.	Same as H.R. 2730, but using age 59-1/2 rather than age 59.	Same as H.R. 2730.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
Effective dates for miscellaneous changes		Effective date.--Years beginning after December 31, 1991, except that the provision relating to distribution from rural cooperative plans applies to distributions after the date of enactment.		Effective date.--Years beginning after December 31, 1991, except that the provision relating to distributions from rural cooperative plans applies to distributions after the date of enactment.	Effective date.--Years beginning after December 31, 1991, except that the provisions relating to distributions from rural cooperative plans applies to distributions after the date of enactment.

DISCUSSION

In general

Under present law, the administrative burden on employers to comply with some of the basic rules applying to qualified retirement plans outweighs the small potential benefit of the rules. For example, rules triggered by the attainment of fractional ages are difficult to remember and apply but are of insignificant benefit to plan participants. When adjusted dollar limits are not published until after the beginning of the year to which they apply, it creates uncertainty for plans sponsors and sponsors who must make decisions under the plan that may be affected by the limits. Applying the same set of rules to plans maintained by unincorporated employers as apply to other employers makes the qualification standards easier to apply and administer. Conforming the penalty structure for failure to file reports of pension and annuity payments simplifies the overall penalty structure by making it uniform for most failures to file information reports. Permitting employers to continue to make contributions to a defined contribution for all disabled employees, not just to those that are not highly compensated, provides fairer treatment to disabled employees. However, any such rule should not be discriminatory in operation.

One downside to some of these changes (e.g., modifying the half-year requirements) is that all employers would be required to amend their plan documents to reflect the changes. As a result, some may argue that the changes add more to an employer's administrative burden than they remove.

VEBAs

H.R. 2641 and H.R. 2742 would clarify the tax-exempt status of nationwide VEBAs by providing that the law in effect in the 7th Circuit would apply generally. Thus, under the bills, employers with a sufficient employment-related common bond would be permitted to participate in a nationwide VEBA.

Proponents of the bills provisions argue that there is no justifiable reason for the position of the IRS that limits, in the case of unrelated employers, the availability of a tax-exempt funding arrangement for employer-provided benefits to employers who operate in the same metropolitan area. They point out that limiting the eligibility to participate in a VEBA to employers within the same geographic area tends to discriminate against employers whose businesses are located in rural areas or whose trades or businesses are sufficiently unique that only a few employers in the same line of business will operate in any given geographic area.

On the other hand, some are concerned that the availability of nationwide tax-exempt VEBAs

essentially creates tax-exempt insurance companies by permitting a large number of unrelated employers to pool their risks in order to reduce the cost of providing life insurance and health insurance to their employees. If a sufficient number of employers participate in such a nationwide VEBA, then the VEBA operates in essence as a tax-exempt insurance company, thereby competing directly with taxable insurance companies. Those who oppose the proposal point to the substantial number of industry trade associations that could sponsor nationwide VEBAs. They argue that the long-term revenue consequences of the proposal and the long-term effects the proposal could have the financial health of existing taxable insurance companies should be carefully considered before such a proposal is enacted.

In-service distributions from rural cooperative plans

Allowing in-service distributions after age 59 (or 59-1/2) from cash or deferred arrangements maintained by rural cooperatives extends the treatment given to employees of other employers to employees of rural cooperatives.

Determination of employee contributions under defined benefit plans

Prior to the enactment of the Pension Protection Act of 1987, employee contributions to a defined benefit plan were credited with interest at a rate of 5 percent. The Pension Protection Act required that a market rate of interest be used and also eliminated the provision that capped the total amount of employee contributions at the level of the employee's benefit accrued under the plan. In many cases the prior-law rules operated to the benefit of employers who could take advantage of the difference between the 5-percent rate and the rate earned by the plan.

Proponents of the changes in H.R. 2641 argue that the PBGC interest rate is a more appropriate interest rate. Opponents argue that the provision would undermine the intent of the Pension Protection Act, which was to ensure that employees are credited with a fair rate of return on their investment.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
I. Plans of State and Local Governments and Tax-exempt Organizations					
1. Modifications to limits on contributions and benefits	The maximum annual benefit payable under a qualified defined benefit pension plan is generally the lesser of (1) 100 percent of the participant's high 3-year average compensation, or (2) $108,963 (for 1991, indexed). The dollar limit is actuarially adjusted downward in the case of early retirement. The maximum annual additions that can be made on behalf of a participant in a defined contribution plan is the lesser of (1) $30,000, or (2) 25 percent of compensation.	No provision.	No provision.	The bill exempts participants of State and local government defined benefit plans from the 100 percent of high 3-year average compensation limitation. Also, benefits provided under a "qualified excess benefit arrangement" (which is treated as a nonqualified deferred compensation plan for tax purposes) are not taken into account for purposes of applying the limits on contributions and benefits. Survivor and disability benefits also exempt the limits on contributions and benefits. The bill also provides that the compensation of participants in such plans includes, in addition to the usual amounts, amounts contributed pursuant to a salary reduction agreement that are not includible in the participant's income. Under the bill, governmental plans are treated as satisfying the limits on contributions and benefits for all taxable years beginning before the date of enactment. Effective date.--Taxable years beginning after date of enactment.	Same as H.R. 2641. Effective date.--Taxable years beginning after date of enactment.

ITEM	PRESENT LAW	MR. ROSTENKOWSKI H.R. 2730	ADMINISTRATION PROPOSAL	MR. CHANDLER H.R. 2641	MR. CARDIN H.R. 2742
2. Section 457 not applicable to non- elective deferred compensation	Deferrals under nonqualified unfunded deferred compensation plans maintained by State and local governments and tax-exempt employers (other than churches) are subject to annual limitations and certain other restrictions (sec. 457). Under these limitations, deferrals for the year generally are limited to the lesser of $7,500 or 33-1/3 percent of the participant's compen- sation.	No provision.	No provision.	The bill provides that section 457 does not apply to nonelective deferred compensation. Nonelective deferred compensation is to be defined under regulations. Effective date--Years beginning after December 31, 1991.	No provision.

DISCUSSION

Modifications to limits on contributions and benefits

Proponents of the provisions modifying the limits on contributions and benefits for governmental plans argue that such plans have special circumstances that warrant exceptions from the general rules. For example, with respect to the exemption from the 100 percent of compensation limitation, they argue that the compensation structure for certain government positions is such that the employees are paid very low current compensation, but are compensated instead with retirement benefits. Also, they argue that in the private sector, disability and similar benefits are often paid outside of a qualified plan, whereas they are paid from qualified plans in the public sector. Further, they argue that private employers are allowed to maintain excess benefit plans (i.e., plans that pay benefits that cannot be paid from a qualified plan because of the limits on contributions and benefits), but public plans cannot maintain excess benefit plans because of the limitations imposed under section 457 (discussed below). Finally, they argue that the scrutiny afforded compensation of public employees is sufficient to ensure that excessive benefits are not paid and that no further Federal limitations are necessary.

Opponents of the provision argue that the provision is merely an exemption from the limits on contributions and benefits, and that the public employees should not be treated more favorably than private sector employees. For example, all low wage employees could benefit from an exemption from the 100 percent of compensation limitation. Similarly, many private employers have pointed out that lower-paid employees are hurt because compensation for purposes of the limits on contributions and benefits does not include salary reduction amounts, such as contributions to a 401(k) plan. Further, they argue that as a matter of public policy, public plans should be subject to the same rules as plans of private employers and that employees in public plans obtain significant Federal tax benefits under qualified plans.

Section 457 not applicable to nonelective deferred compensation

H.R. 2641 provides that section 457 does not apply to nonelective contributions to an unfunded deferred compensation plan maintained by a State or local government or a tax-exempt organization. Thus, under the bill, nonelective contributions are not subject to the dollar and percentage of compensation limitations contained in section 457. Proponents argue that this is merely a clarification of present law, and that section 457 was never intended to limit the amount of nonelective contributions that could be made to an unfunded plan maintained by plans of governments and tax-exempt organizations. They point out that section 457 was enacted to limit elective deferrals because the usual tension between an employee's desire to defer compensation and the employer's desire to obtain a current tax deduction for compensation paid is not present where the employer is tax exempt. They argue that where the employee does not control the amount of deferrals, as in the case of nonelective contributions, the limitations imposed by section 457 are not necessary.

Opponents of the provision contend that the argument that section 457 only applies to nonelective deferred compensation is not well supported. The statute on its face is not so limited, but refers to all deferred compensation. Moreover, the position of the Treasury Department is that section 457 applies to all deferred compensation.

Further, they argue that defining nonelective deferred compensation is extremely difficult and complex. For example, the extent to which an individual has bargaining power with respect to a compensation package is indicative of whether or not deferred compensation is nonelective; however, it will be impossible for the IRS to monitor the degree to which a compensation package has been negotiated.

III. OTHER PROPOSAL

H.R. 2390 (Mr. Gibbons): The Pension Coverage and Portability Improvement Act of 1991

Establishment of portable pension plans

The bill requires each employer to establish an individual account plan into which employees may make salary reduction contributions. This requirement may be satisfied by amending an existing pension plan to add a salary reduction feature that qualifies as a portable pension plan, by adopting a minimum-benefit pension plan with a salary reduction feature, or adopting a separate portable pension plan.

A portable pension plan is a qualified plan (sec. 401(a)), a simplified employee pension (SEP) (sec. 408(k)), individual retirement arrangement, or tax-sheltered annuity (sec. 403(b)) that (1) meets the requirements of the rules relating to SEPs, (2) provides that benefits may be transferred from another plan into the portable pension or from the portable pension to another plan, (3) permits participants and beneficiaries to direct investments in the manner provided under title I of the Employee Retirement Income Security Act of 1974 (ERISA) (ERISA sec. 404(c)), and (4) provides that, unless the participant and his or her spouse elect otherwise, distributions from the plan are made in a permitted retirement income form.

A distribution is made in a permitted retirement income form if it is made in the form of a qualified joint and survivor annuity, any other joint life annuity, a single fie annuity, or in the form of substantially equal periodic payments over the life expectancy (or expectancies) of the participant (or the participant and his or her beneficiary). The bill requires the administrator of a portable pension, immediately before making a distribution, to provide to the recipient a written explanation of the income tax rules applicable to the distribution, the terms and conditions of the form of distribution, and the right to elect another form of distribution.

The bill requires the Secretary of Labor, in consultation with the Secretary of the Treasury, to prescribe by regulation one or more prototype portable pension plans which can be adopted by plan sponsors.

Penalty for early withdrawals

The bill increases the present-law penalty for early withdrawals (generally, nonannuity distributions prior to age 59 1/2, death or disability) from qualified retirement plans (sec. 72(t)) from 10 percent to 25 percent.

Minimum benefit pension system

The bill requires all employers who are engaged in commerce or in any industry or activity affecting commerce to establish a minimum benefit pension plan. A minimum benefit pension plan is a qualified plan (sec. 401(a)) or tax-sheltered annuity (sec. 403(b)) which meets the following requirements: (1) all employees who have 1 year of service are participants in the plan; (2) in the case of an individual account plan, the employer makes an annual contribution for each participant of at least 6 percent of compensation; (3) in the case of a defined benefit plan, each participant's accrued benefit derived from employer contributions is equal to the greater of (a) the accrued benefit under the plan, (b) the present value of accrued benefits, or (c) the amount of the participant's accrued benefit which would have been derived had the employer made the contributions required with respect to individual account plans; and (4) employee

contributions are 100 percent vested. The minimum contribution requirements are phased in over 3 years.

In the case of a defined benefit plan, the present value of accrued benefits under a minium benefit pension plan is determined using an interest rate of 3 percent. The 3-percent rate is phased in over 3 years.

The bill also provides a special method of applying the limits on contributions and benefits (sec. 415) in the case of salary reduction contributions to a minimum benefit pension plan.

An employer that fails to meet the minimum benefit plan requirements is liable for an excise tax equal to 110 percent of the amount by which the total minimum benefit pension plan contribution exceeds the amount actually contributed by the employer.

Effective dates

The provision with respect to the establishment of salary reduction portable pension plans is effective 24 months after enactment.

The increase in the early withdrawal tax applies to distributions after January 1, 1991.

The provisions relating to the minimum benefit pension system are generally effective 60 months after the date of enactment unless (1) the Secretary of Labor certifies to the Congress that at least 75 percent of full-time workers are active participants in portable pension plans that meet the contribution requirements with respect to minium benefit pension plans, (2) Congress is persuaded by the Secretary of Labor's findings that the goals of universal pension coverage and improved portability has been substantially achieved, and (3) the minimum benefit provisions of the bill are repealed by a simple majority vote of both Houses of Congress.